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ABSTRACT

This report by the Chairman of the Committee on the Budget of the U.S. House of Representatives presents the conclusions of an effort by the committee to outline a possible long-term budget strategy which will take the nation into the 21st century. Between June and December, 1991, the Committee held 16 hearings, 14 caucuses, and 10 briefings in which it conducted an extensive review of the nation's economy, long-term problems in the society, and the status of the budget deficit and the 1990 Budget Agreement. After presenting some background information that summarizes the status of the economy, the deficit and the Budget Agreement the report offers specific policy initiatives designed to restore confidence in the economy and government. Specifically, the program put forth contains the following elements: (1) streamlining and improving management of the Executive and Legislative branches to better serve the American people and formulate and carry out responses to national problems; (2) dramatic reductions in budget deficits over the next decade to below 0.5 percent of gross national product--GNP (compared to the current 6 percent), or preferably a balanced budget in order to free up the nation's resources for more productive private and public investments; and (3) targeted investments in programs chosen specifically to address the most serious long term threats to the nation's economic and social health. Following the chairman's report, additional views are offered by Representative Willis D. Gradison, Jr., the ranking Republican on the Budget Committee. (DB)

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RESTORING AMERICA'S FUTURE:

PREPARING THE NATION FOR THE 21ST CENTURY

A REPORT BY LEON E. PANETTA, CHAIRMAN
WITH ADDITIONAL VIEWS BY
WILLIS D. GRADISON, JR., RANKING REPUBLICAN

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Committee on the Budget
U.S. House of Representatives
December 1991

(This document has not been formally approved by the Committee, and therefore, may not necessarily reflect the views of all of its Members.)

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PREFACE

This report concludes an effort by the House Budget Committee to outline a possible long-term budget strategy which will take this Nation into the 21st century.

In this report I have described the views of the Committee on a number of issues. My report is based on the debate and general conclusions reached in our Committee caucuses. Also, Bill Gradison, the ranking minority member of the Committee, has supplied additional views on the topics covered in this report.

I want to thank Members of the Committee for their participation in the hearings, briefings and caucuses. This report was supplied to them for their review prior to its release. The Members are to be commended for making this effort to develop a long-term approach to the budget under difficult political conditions.

I recommend this report to my colleagues in the House and Senate, and to the President. I hope we can build on it to restore our Nation's future.

LEON E. PANETTA
Chairman, House Budget Committee

INTRODUCTION

Since June 1991, the House Budget Committee has conducted an extensive review of the nation's economy, long-term problems in our society, and the status of the budget deficit and the 1990 Budget Agreement. The Committee has held 16 hearings, 14 caucuses, and 10 briefings. In recent weeks, it has focused on a long-term strategy for promoting economic growth, confronting the budget deficit and societal problems, and improving the structure and management of the Federal government. This report reflects the general conclusions of that effort.

The Committee hearings and briefings focused on a wide range of long-term issues, including education, health care, tax fairness, deficits, the economy, and problems facing children, the elderly, and low-income Americans. The Committee received an extraordinary amount of information on these issues and an equally impressive variety of suggestions on how to address them. Some powerful themes emerged during the Committee's deliberations:

- The nation's economy is as fragile as it has been at any time in the post-World War II era. It is suffering not only from problems associated with the recent recession but also from serious long-term dislocations which threaten the economic well-being of this and future generations.

- While the 1990 Budget Agreement is working to reduce deficits from what they would otherwise be, deficits are projected to grow once again at an alarming

rate during the latter half of the decade, threatening the nation's potential for economic growth and for addressing societal problems.

• The nation faces serious challenges in many facets of our society, including education, health care, housing, infrastructure, crime, and drugs. These problems threaten the nation's ability to achieve economic growth and a better life for our people now and in the future. They raise serious questions about the quality of life our children can expect now and in the next century.

• The demise of the Warsaw Pact, the disintegration of the Soviet Union, and the end of the Cold War have handed the nation a rare, historic opportunity to establish new priorities and begin a decade of rebuilding and change.

• Finally, the confidence of the American people in the ability of the Federal government -- both Executive and Legislative branches -- to serve the public and to address the nation's long-term domestic problems has been badly shaken in recent years. Serious consideration should be given to significant changes in the way government functions.

Guided by these themes, the Committee proposes, for the consideration of the Congress, the President, and the Nation, the outline of a broad ten-year program to prepare the nation for the 21st century. That program contains the following elements: 1) streamlining and improving management of the Executive and Legislative branches of government to better serve the American people and formulate and carry out responses to national problems; 2) dramatic reductions in

budget deficits over the next decade to below one-half a percent of GNP (compared to the current 6 percent), or preferably to balance, in order to free up the nation's resources for more productive private and public investments; and 3) targeted investments in programs chosen specifically to address the most serious long-term threats to the nation's economic and societal health.

This report does not replace the normal budget process. Rather we hope to lay the groundwork for next year's budget resolution and give it a clearer purpose.

A ten-year path to meet long-term goals for the year 2001 still necessitates year-by-year decisions in budget resolutions. The intent is not to recommend specific decisions for FY 1993, but instead to look ahead at where we want the Nation to be in 2001 and propose alternatives for achieving our goals. We believe that resolving the deficit issue and making the necessary investments in growth, productivity and fairness should be the highest priority of the Executive and the Congress over the coming ten years, and that such an effort must begin immediately.

What follows is a more detailed description of the problems the Committee sees challenging the Nation, followed by an explanation of the Committee's proposals for the coming decade.

PART I

THE BUDGET, THE ECONOMY, AND OUR SOCIETY

Despite the accomplishment one year ago of the five-year Budget Agreement between the President and the Congress, the Nation must now address renewed concerns about the state of the budget and the economy. There are two reasons why this is so.

First, the Federal budget deficit continues to be a major long-term threat to the economy. Though record deficits caused by the recession that began last year are projected to subside as the economy recovers, this relief will be short-lived. Even with consistent economic growth, the deficit will begin to rise again by the middle of the decade (see table 1). Without consistent economic growth, there is a real risk that spiraling deficits will continue to spawn spiraling interest obligations -- sending the national debt out of control.

Such high and rising deficits gradually and systematically undermine our nation's future. They burden coming generations with debt; and perversely, they also drain the savings pool that we need to make the investments that can repay that debt and increase our standard of living. Further, they create an atmosphere of uncertainty; they suggest a government that cannot perform, and they confront financial markets with contingencies that produce both volatility and instability.

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Second, both the recession and budget deficits are exacerbating our other economic and societal challenges. A sluggish economy inevitably hurts both businesses and employees, home owners and home buyers, the quality and cost of health care and education, investors and consumers, the unemployed, and the poor. The dearth of private savings and the size of the budget deficit drain the resources that both the President and the Congress need to restore the growth and fairness that are the hallmarks of the American economy. And we face not only a weak economy, with high unemployment and millions of employed workers fearing for their jobs, but also urgent societal problems -- from inadequate education and health care to homelessness and a fragile infrastructure -- that threaten current and future generations. At the very moment in history when the United States must provide both economic and competitive leadership in the world, opportunities may be irretrievably lost.

Problems of this magnitude cannot be addressed in the normal course of business. The Budget Committee believes it is important to sound the alarm and call attention to the price that this Nation will pay if the deficit is allowed to follow its present path and societal problems are not addressed; to present a long-term strategy for the deficit and the other budget-related needs of our society; and to restore confidence in both our economy and our government.

1. The Economic Outlook

It is unclear whether the recession that began in July of last year is over. What is clear, however, is that the economy is weak.

Even the most optimistic forecasts suggested that recovery from the recession would be modest, if only because the recession itself would be "short and shallow." As events have unfolded, however, the recovery is even more modest than forecast or it is not yet a recovery at all. One sluggish sector is exports, which had been a major source of strength for the past five years. A second is near-stagnant commercial real estate construction; almost twenty percent of commercial space in major markets is estimated to be vacant, suggesting that further construction will not be undertaken until after an extended period of broadly based economic growth.

Perhaps the most important cause of the current economic sluggishness is stagnant consumer spending. Consumer confidence was shaken by the Persian Gulf war, then recovered, but has since declined again. Household incomes have grown slowly as well, in large part because productivity growth has been limited; and so real wage growth has been slow or even negative. In those recent years during which the unemployment rate has been under six percent, productivity growth has averaged only about one percent. Unless we can achieve faster

productivity growth, overall economic growth over the long term will be 2.5 percent per year or less. Such mediocre growth will add little to U.S. standards of living.

Furthermore, reaching a lower level of unemployment will be far from easy. Fiscal policy is a weak tool against this recession, because the deficit is already so large. Prospects of increased budget deficits, and consequent Federal borrowing, could frighten financial markets and increase interest rates; higher interest rates would choke off investment and big-ticket consumer spending, stifling the economy. But monetary policy's latitude is limited to some degree as well. U.S. interest rates cannot fall too far below those of other nations so long as we must borrow heavily from abroad to finance our large budget deficits (and other credit needs). This lack of policy flexibility will hinder the economy in its fight to break loose from recession.

Some observers see significant economic opportunities in the lessening of world tensions and the consequent potential to reallocate resources from our national defense to domestic purposes. Others see a similar opportunity in savings that could be achieved through structural reforms in our health care system. In fact, however, either of these long-term opportunities would involve short-term dislocations, as some workers in the defense industry or the health industry would find that their jobs were no longer needed. Until these workers were able to find

new, productive jobs, their incomes would be reduced, and their reduced spending would slow the economy. In instances where those burdens were concentrated geographically -- such as the closure of a military base or plant, or of a hospital in a small community -- the local dislocation would be far more painful than the impact nationwide.

2. The Deficit Outlook

Slow economic growth has a direct effect on the budget deficit; slow growth of incomes yields both slow growth of revenues and increases in income support payments. Unless economic performance improves markedly -- through both a quick onset of recovery in the near term, and more rapid productivity growth in the long term -- progress on the deficit will be elusive.

Two other factors will markedly affect the path of the deficit. The first is the cost of the twin cleanups of failed savings and loans and commercial banks. The near-term deficit is quite sensitive to the number and sizes of failures of financial institutions. The costs of the cleanup have far less immediate impact on the economy than other types of government spending; replacing money in a passbook savings account in a failed thrift is very different from actually purchasing a good or a service. However, the greater the financial institution

failures, the larger the National debt -- and the larger the ultimate annual net interest cost.

The second factor is the rate of growth of public health-care costs. Spending on both Medicare and Medicaid is projected to grow at double-digit rates into the foreseeable future, driven in part by expanding caseloads (from both demographic change and Medicaid program liberalizations), in part by health-care price inflation (on average, 2.5 percentage points per year faster than inflation in general), in part by higher utilization caused by technological advances that yield better but more expensive treatment, in part by more intensive treatment, and by other factors. These medical care programs have already grown so large -- over 14 percent of total outlays in the current fiscal year -- that their continued rapid growth is a major determinant of future budgets and deficits.

The House Budget Committee (HBC) staff projects that the total deficit (including Social Security spending and revenues) will fall from a peak of $362 billion in FY 1992 (6.1 percent of GNP) to $179 billion in FY 1996 (2.4 percent of GNP), as the economy recovers from recession (see table 2). Absent the influences of the thrift cleanup, the deficit would fall from a peak of $248 billion, or 4.2 percent of GNP, to $213 billion in FY 1995, or 3.0 percent of GNP. However, the fundamental factors -- slow long-term economic growth, rapid medical-care cost growth, and the lingering debt-service costs of an expensive

financial institutions cleanup, as well as other, smaller influences -- will drive the deficit upward in the long term even if the economy is basically stable. By FY 2001, the HBC staff projects the deficit to have grown to $335 billion -- 3.3 percent of GNP ($325 billion, or 3.2 percent of GNP, not counting the last effects of the thrift cleanup).

3. Implications of the Deficit

Such large future deficits are unacceptable.

The projections portray a budget in a precarious state; the deficit in the latter part of this decade will grow faster than the economy -- that is, faster than the GNP -- while the Federal Government's debt service costs are barely holding even by that standard. If the economy fails to match its projected growth rate or interest rates are higher than expected, the Nation's debt service costs will grow markedly faster than the economy. When individuals find that they cannot meet the interest payments on their accumulated debt, the inevitable result is bankruptcy; for the Federal Government the inevitable result is continuing economic turmoil.

Even if the economy fulfills the economic projections underlying this deficit path, the effect of the growing debt on our standard of living over the long term

would be most harmful. These large and continuing budget deficits would drain our Nation's savings pool and reduce productive investment. The resulting lower investment would mean less productivity growth and less future income. If other nations were willing, we could finance our investment out of their savings -- by borrowing from them, or by selling them our assets, as we have to a marked degree in recent years. However, foreigners would then take over more of our wealth, and would receive the income generated by that wealth. Further, that process of borrowing from overseas could again drive the dollar's value upward, encouraging imports, discouraging exports, and destroying American manufacturing jobs. Such large deficits impart additional uncertainty to interest rates and currency values that reduces businesses' ability to plan, and would hence likely reduce overall economic performance.

Finally, such continuing large deficits would hamstring Government. Future administrations and Congresses would not have the resources to address the Nation's needs or to provide incentives for productive activity; the deficits would even further reduce the range of public policy discretion. The Committee recognizes the cost of forgoing incentives or investments that would strengthen the economy and ultimately pay for themselves in revenues or reduced costs to the Federal Government.

4. The Status of the Budget Agreement

Though the projected deficit growth is dangerous and must be reversed, the deficit problem did not reappear because of a failure of the 1990 Budget Agreement to do what it was designed to do. In fact, the Agreement has delivered real budget savings through spending cuts and tax increases -- $368 billion so far. The challenge is to build on that progress to turn the deficit around.

The agreement was negotiated with the assumption that the economy would remain basically stable. Under that condition, controlling spending would control the deficit, as economic growth would increase revenues faster than the constrained growth of outlays.

The Agreement has held spending below where it would otherwise be, and so the deficit is lower than it would have been without the Agreement. Significant entitlement spending cuts, including over $45 billion in Medicare over five years, were enacted in the Agreement itself. Discretionary savings targets have been met; use of the emergency clause in the Agreement -- as opposed to the exclusion for the Gulf War and for the savings and loan cleanup, originally agreed to by the President and both parties in the Congress -- has been extremely limited. The constraints of the discretionary spending caps and the pay-as-you-go procedure for

entitlements have been acknowledged on all sides to have forestalled decisions to increase spending.

The deficit has increased for two major reasons.

First, the Agreement did not, apart from the Medicare cuts, address the underlying growth of existing entitlements. Since the Agreement, it has become clear that Federal medical care costs (especially for Medicaid) are growing more rapidly than anticipated. When that growth is extrapolated ten years into the future, it drives the deficit well beyond the levels projected over a five-year horizon in 1990.

Second, the economy has been weaker than expected, increasing the deficit in three ways. First and foremost, a recession and a sluggish recovery have reduced tax revenues and increased unemployment compensation and other income support costs. Second, the slow economy has further weakened the financial institutions, making the thrift cleanup costs somewhat greater. And third, every dollar of additional Federal debt accumulated in the near term bears interest in the long run, so high deficits today breed higher deficits tomorrow.

5. A Society in Trouble

Over the past decade, a number of major problems in our economy and society have continued to grow. Concern about deficits has certainly been a factor in limiting consideration of bold solutions. Too often, however, there has been a reluctance to act based upon the viewpoint that the Federal government has little or no role to play in responding to these problems.

The Committee believes that there is a legitimate role for government but that significant change is necessary in government itself if it is to be a viable tool for addressing the Nation's ills.

Likewise, the Committee obviously accepts the need to control deficits. At the same time, the Committee believes that deficit-reduction efforts and societal and economic investments go hand-in-hand. They complement one another in any intensive, realistic effort to restore long-term economic growth and to make a better society.

6. Shrinking Confidence in Government

By virtually any measure, it seems clear that the American people have become less confident of their government's ability to function. The trend is reflected in public opinion surveys, in the withdrawal of millions of Americans from the political process -- as shown by the shocking decline in voter turnout in national elections -- in the current drive for term limitations for all levels of

government, and in the day-to-day conversations Members of Congress have with their constituents.

Generally, there is a belief that government has gotten too big, that it is out of touch with the American people, that it is wasteful, that it does not function well, and that it is, at best, ill-equipped for taking on the problems the American people face or, at worst, is directly responsible for those problems.

It is the belief of Members of this Committee that, all too often, these perceptions are accurate. This is not to say that government -- big or small -- is inherently not capable of functioning well or of addressing problems. Rather, the Federal government, at this time, has become unwieldy, insensitive, and resistant to change.

Given the problems this report has already discussed, it is difficult to conceive of the Executive and Legislative branches of government dealing adequately with the solutions the Committee will propose unless broad managerial and structural changes are undertaken.

7. Conclusion

The President and the Congress must cooperate to bring down deficits, to make, and pay for, investments in our economy and our society, and to improve the operation and structure of the Federal government. These are tasks so large that only a long-term view can encompass them. Further, we must emphasize to

our colleagues and to the administration that the steps required to achieve these goals are beyond the range that elected officials normally contemplate. However, we believe that all of us must confront this reality now, lest it confront us on even less favorable terms later.

What follows is a series of discussions and recommendations of specific policy steps to address these issues. While the Committee is not unanimous in its views on each particular, we are unanimous on the need to address this family of options and to achieve a net result of a budget that is under control and a society making productive investments in its future. The ultimate choice of particular options will be made in the formal budget and legislative processes, which is their proper role, but the Committee believes these decisions must be related to a long-term economic recovery plan aimed at restoring America's future.

Part Two

RECOMMENDATIONS:

RESTORING CONFIDENCE IN THE ECONOMY AND IN GOVERNMENT

The Committee, believing that the deficit and our budget-related ills are crucial, has developed a comprehensive list of potential policy remedies. While there are differences among Members as to the particular elements in each area, there is consensus that the focus must be on (1) streamlining government; (2) deficit reduction; and (3) investments in growth. The specific recommendations discussed follow.

1. Streamlining Government

The Committee believes that neither budget control nor effective investments can be achieved without better management within the Executive branch, and that improved delivery of services is essential to increased public confidence in Government. The Committee further believes that structural reform must extend to the Congress, as much as to the Executive branch.

A. Strengthen the Management Function in the Executive Branch

By its own admission, the Office of Management and Budget (OMB) has failed to execute its management responsibilities adequately, resulting in significant costs to the taxpayers in conspicuous management breakdowns in recent years. Some Members of the Committee would establish a separate Office of Federal Management to focus greater attention on the management role of OMB. This would provide the executive oversight needed to ensure that each agency administers its primary function, improves management capacity and controls future costs. All Members support and reinforce the avowed efforts of the current OMB to upgrade its government-wide management function.

The erosion of the management function in the Executive branch has weakened adherence to basic organizational principles. Without such principles, there is little to prevent management breakdowns. Rather, control systems are established to detect problems after the damage is done -- the proverbial closing of the barn door after the horses have escaped. By whatever means, prospective management must be revived to head off future unnecessary budgetary costs before they occur.

B. Reorganization of the Executive Branch

Congressional committees, the General Accounting Office, and outside organizations and commissions (for example, the Volcker Commission) point to structural weaknesses in the executive agencies that hinder them in performing the most essential tasks. The disaggregation of departments and agencies into smaller units, often with their own personnel systems and other overhead, lengthens lines of control and communication, increases costs, and complicates oversight. There are numerous examples, but two should suffice: responsibility for wetlands is divided among four departments, five bureaus, and one independent agency, while food safety responsibility is dispersed among six federal bureaus. Under these circumstances, it is difficult to formulate policy, target resources to priority problems, and assign responsibility.

The Committee recommends the appointment of a new commission to take a fresh look at Executive branch organization and structure. Such a panel could follow in general outline the first Hoover Commission in the late 1940s and the Ash Council in the early 1970s. The commission should examine and make recommendations regarding: (1) consolidation and reduction of the fourteen major departments and the independent agencies; (2) evaluation of the legal and organizational status of government corporations, government-sponsored enterprises, and federal "instrumentalities;" (3) review of the status and capabilities

of central managerial agencies in the Executive branch, including organizational design and planning, central legislative review, regulatory review and clearance, financial management systems oversight, procurement oversight, personnel systems, program evaluation, and management of "third-party" activities; (4) evaluation of the application of new information technology to reduce costs; and (5) consideration of the role of service delivery consolidation, and "one-stop shopping" and other outreach, in streamlining service delivery and cutting costs.

C. Reorganization of the Congress

The Congress must improve its operations as well, both to meet policy challenges and regain the public trust. A joint committee or commission should consider and make recommendations concerning: (1) the number and jurisdiction of standing committees and subcommittees; (2) oversight of Federal programs based on performance as well as process; (3) staffing of both Committees and Member offices; and (4) internal administrative structure, and (5) parity of treatment of Members, and the Congress as a whole, relative to the Executive branch and the private sector, subject to the separation of powers in the Constitution.

The recommendations concerning both the Executive branch and the Congress should be available no later than January 1, 1993. Some Members

would provide for mandatory votes in the Congress on those recommendations, patterned after the base closure process.

Estimates of cost savings from organizational and management initiatives are difficult to assess based on past experience. However, the Committee would set a target for savings from management efficiencies and departmental consolidation of from $3 billion to $5 billion in FY 2001, and between $15 billion and $25 billion over the ten-year period. This target is extremely modest compared with claims for past reorganization and management efforts, and is intended to motivate all concerned to pursue every potential efficiency. In addition to budget savings, however, the effort of streamlining is important to enable executive agencies to better focus resources on the needs of people in the coming years.

2. Deficit Reduction

The Committee endorses the goal of reducing the deficit from its projected FY 1992 peak of $362 billion, or 6.1 percent of GNP, to less than 0.5 percent of GNP, or preferably a balanced budget, by the beginning of the next decade. Without changes in policy, HBC projects that the deficit will increase from mid-decade to $325 billion in FY 2001. Reducing that deficit to our goal of less than 0.5% of GNP, or preferably to balance, would require cumulative deficit reduction

reduction of between $1.0 trillion and $1.5 trillion over the decade. To do this, the following areas must be considered:

A. Defense Discretionary Spending

Though the direction of defense spending has changed from a decade ago, the controversy surrounding the defense program has not.

In response to the 1989 collapse of the Warsaw Pact, defense spending was cut in the 1990 budget summit agreement. Defense caps (adjusted to include spending for Desert Storm) were set to bring outlays down from $322 billion (5.8 percent of GNP) in FY 1991 to $295 billion (4.7 percent of GNP) in FY 1993.

The House Budget Committee examined defense options pending the recommendations of the Armed Services and Appropriations Committees.

Some Members of the Committee believe that defense could be a major source of outlay reduction. They hold that the administration's 20 percent reduction from the baseline that was in effect at the time of the budget summit takes into account the reduced world tensions from the fall of the Warsaw Pact but not the reduction of the threat to our security from the subsequent virtual collapse of the Soviet Union as a world power -- in fact, as a unified nation.

The evidence of the Soviet Union's changed posture and capability is considerable:

- the Soviet withdrawal from Afghanistan and reduced involvement with former distant client states;
- the unilateral Soviet conventional force reductions announced by President Gorbachev at the United Nations in December 1988;
- Soviet approval of the Intermediate-range Nuclear Forces (INF) and Conventional Forces in Europe (CFE) agreements, the Strategic Arms Reduction Treaty (START), the U.S.-Soviet agreement to destroy chemical weapons; and the U.S.-Soviet joint verification agreement concerning nuclear tests;
- the recent U.S.-Soviet actions regarding strategic and tactical nuclear weapons;
- Soviet cooperation during the Persian Gulf crisis;
- Soviet acquiescence in the dissolution of the Warsaw Pact, moves by eastern European nations toward democracy, and the unification of Germany within NATO;
- the failure of the August 1991 Soviet coup, and the refusal of major elements of the Soviet military to support it;
- the collapse of the Soviet economy and moves toward conversion of its defense industry; and
- the December 1991 de facto dissolution of the Union itself.

The world is far less dangerous and unpredictable than even one year ago. While it is true that no one predicted the precise nature and timing of Iraq's invasion of Kuwait last year, for example, it is also true that belligerent action by Iraq would have been on every expert's list of potential threats to our security and the world's stability at that time. Such a comprehensive list today would include the following threats:

- a dismantled Soviet Union with various republics having military forces, possibly including nuclear weapons;
- a reconstituted Soviet Union which again becomes an expansionist, totalitarian threat to Western Europe (though the Department of Defense estimated one year ago that it would take the Soviet Union two years to rebuild its military to be capable of invasion of Western Europe on short notice; and such a military buildup would surely take longer now, and would be obvious from the first given the increased openness of the Soviet society);
- China, which is not a strategic or technological match for the United States;
- North Korea, which is less advanced than China and less likely than previously to have support from other nations, and whose threat is counterbalanced by a capable South Korean military;
- the Middle East/Persian Gulf, where a weakened Iraq is counterbalanced by a strong Israeli military and a reduced concern about Soviet intervention;

- aggression of minor powers against their neighbors, India and Pakistan for example, or small nations that develop nuclear weapons; and
- terrorist activities over drugs or other causes.

Significantly, none of the listed threats -- except a highly unlikely reconstituted Soviet Union, which could develop only with considerable lead time; or an equally unlikely ground war against China, which the United States could and should choose to fight on other terms -- calls for the large conventional force that consumed the vast bulk of our defense budget throughout the Cold War period. In fact, none of those threats would call for an effort on the scale of Operation Desert Storm -- which was mounted with under half of the major forces that would be available after all of the administration's proposed reductions. Most of the other threats are more appropriately addressed by diplomatic and economic actions and with smaller, more flexible military forces. The remainder of the threats are deterred with nuclear weapons, which our arsenal already holds in abundance and which account for only about 15 percent of defense spending in any event.

The Soviet threat to Western Europe has been the biggest expense to the U.S. defense establishment, and the developments of the past year -- the collapse of the Soviet Union, on top of the disintegration of the Warsaw Pact -- significantly lighten that U.S. security burden in two distinct ways. First, the maximum force that the Soviet Union could apply to Western Europe is greatly reduced; and

second, the warning time of such an attack is greatly increased. Therefore, the United States and its allies do not need so large a military establishment; and in the case of the United States, that military establishment can be kept outside of Europe -- where it would be less expensive, and where it can address contingencies elsewhere too.

Members of the Committee who hold this view of the threat to our national security believe that our defense establishment now is well beyond our needs. Further, they hold that the defense budget is subject to such inertia -- because of existing long-term procurement commitments and the human costs of personnel reductions -- that it would take several years to cut defense spending to a level commensurate with the current threat. Thus, if we pursued such reductions, we would have the luxury of observing world developments as we go. And with the decline of the industrial capacity of the Soviet Union, there would be no new generation of competing weapons; our existing weapons would define the state of the art. No competitor nation could develop a technological threat to our existing weapons before we could detect that effort and move to our own next generation of weaponry.

The first three years of this proposed path would reduce defense spending sufficiently to maintain domestic and international discretionary spending at its baseline in FY 1994 and FY 1995 while maintaining compliance with the overall

discretionary spending cap contained in the Budget Agreement. While the administration's most recent budget would cut the 1990 baseline defense spending by 21 percent by fiscal year 1995, this proposal would require a reduction of 27 percent, essentially an additional six-percent cut.

These Members believe that the resulting 1995 defense establishment would still be excessive for the threat as it exists today and might be expected to exist then. Thus, subject to continual review and contingent upon continuing favorable political developments around the world, this path would continue with inflation-adjusted reductions of five percent per year. If the world does not evolve favorably, defense spending could revert to a baseline, inflation-adjusted path, or even be increased if need be. While not all of the following developments would be necessary precursors to further reductions, each would add to the argument for them:

- completion of Soviet troop withdrawals from Poland and eastern Germany;
- Soviet compliance with arms control agreements and previously announced unilateral reductions, and positive resolution of issues relating to the location of, and authority over, remaining Soviet nuclear capabilities;
- further reductions in Soviet strategic and conventional forces, the conversion, as already announced, to a voluntary force, and reconfiguring forces toward defense purposes;

- continued Soviet movement towards openness, democracy and private enterprise;
- Soviet military withdrawal from Cuba;
- resolution of the Soviet Union's dispute with Japan over the Kurile Islands;
- continued and expanded Soviet cooperation in areas of mutual concern (for example, the Persian Gulf, combating terrorism, and preventing the spread of Soviet weapons and arms technology);
- improvements in other traditional adversary nations such as China (reduction of the size of its military and its exporting of weapons of mass destruction) and North Korea; diplomatic progress in the Middle East; and interruption of nuclear and chemical weapons proliferation; and
- possibly most important, Soviet conversion of its massive defense industrial base to a size more consistent with its legitimate defense needs.

Other positive international developments would involve our relations with our traditional allies. Their military establishments should evolve into stronger cooperative relationships with ours, as was begun in Operation Desert Storm. It is assumed that the growing economic strength of our traditional allies would give them both the resources and responsibility to assume a greater burden of providing for world security. Such arrangements would ease our burden of countering potential threats worldwide.

The U.S. defense commitment must be monitored and adjusted continuously, but three broad scenarios might be considered. If positive developments such as those described above did not materialize, then the defense reductions completed by FY 1995 could be determined to be the maximum consistent with our national security, and spending could be adjusted for inflation thereafter. Under that scenario, cumulative outlay savings through FY 2001 relative to the HBC baseline would be about $174 billion (see table 3).

If the threats to our national security continue to diminish, reductions at an inflation-adjusted rate of five percent per year might continue through FY 1998, with constant real spending thereafter. Under this more favorable scenario, the cumulative outlay savings would be $360 billion; the real level of defense spending would then be about 40 percent below the baseline in use at the time of the budget summit and 20 percent below the administration's proposed spending.

Finally, if reductions continued at an inflation-adjusted five percent per year through FY 2001 due to continued favorable international developments, the cumulative outlay savings would reach $419 billion; real spending would be almost 50 percent below the summit baseline, 30 percent below the administration. Even at this lowest alternative level of spending, the force structure would still be sufficient to mount Operation Desert Storm (a useful yardstick, even though none

of the remaining threats shows the potential for requiring an operation on that scale), and so this most optimistic path still leaves a considerable margin of safety.

Defense program reductions of this scale unquestionably would put pressure on communities and workers. One possible response would be to provide targeted defense funding for job retraining and community assistance, as in the FY 1991 Defense Authorization bill.

Other Members of the Committee are more skeptical of the potential for defense savings than those who advocate the above program. They believe that the threats in the world continue to justify the defense establishment as defined in the administration's most recent budget, that the Soviet nuclear threat remains strong, and that recent positive developments in the Soviet Union are easily reversible. They are concerned that the Congress would likely restrict the Defense Department's freedom to configure an efficient down-sized force; they cite recent examples, such as prohibitions of involuntary personnel separations or of reductions in Guard and Reserve units. To some extent, they doubt that the Congress can legislate large defense cuts when bases and defense plants would have to be closed, because of the pain that would be caused to local economies.

There is no question that large defense savings would facilitate both deficit reduction and targeted investments in areas of need. In fact, without significant

defense savings, a balanced or near balanced FY 2001 budget is probably out of reach. A majority of the Committee recommends that we accelerate current defense reductions to a steady and manageable path, shape an efficient but smaller force, and constantly monitor world events along the way to assure sufficient U.S. strength to meet all potential threats.

B. International and Domestic Discretionary Spending

International discretionary spending is a small fraction of the budget ($21 billion in FY 1993, or 0.3 percent of GNP), but it is subject to the same massive international change that has driven our reevaluation of the Nation's defense posture.

In the 1970s, development and humanitarian assistance generally exceeded security assistance by a narrow margin, but security assistance has grown significantly larger in the 1980s. Gradually reducing security assistance -- which has been predicated in part on the Soviet threat -- could contribute to deficit reduction. Many nations received security funds or hardware based on potential Soviet support of insurgency; now, such assistance might be seen as more destabilizing than stabilizing. However, a significant share of security assistance goes to Israel and Egypt; therefore, the amount of potential savings is highly dependent upon diplomatic progress in the Middle East.

Other savings might be sought in the radio operations of Voice of America and Radio Free Europe/Radio Liberty, given the changed tenor of international relations. The United States might consider reducing its embassy and consular presence around the world, or reducing its export financing through the Exim Bank.

Humanitarian needs around the world are as pressing as ever, and some Members argue that development assistance is a sensible priority for use of the savings from current security assistance and other international affairs programs. The United States also risks losing influence in a new world order less driven by raw military strength if it continues significantly in arrears to the United Nations, and if other nations increase their relative contributions to the international development organizations (including the International Monetary Fund and the World Bank).

The Committee staff projects baseline domestic discretionary outlays of $225 billion in FY 1993 (identical to the Budget Enforcement Act cap for that year, as revised to date), growing to $314 billion in FY 2001. (Baseline growth averages about 4.3 percent per year, reflecting inflation and increased personnel costs, but no real growth.) The defense reductions proposed above would allow nondefense programs to grow at that baseline in FY 1994 and FY 1995 within the confines of the Budget Agreement.

Since the mid-1970s, funds for domestic discretionary programs have been reduced from about 5.5 percent of GNP to about 3.5 percent. By way of perspective, net interest on the national debt is projected to exceed domestic discretionary spending by FY 1993.

Unlike the entitlement category, which is dominated by a few very large programs, the domestic discretionary category is comprised of hundreds of diverse programs. The largest elements include transportation programs financed by the Highway Trust Fund, Veterans medical care, subsidized housing, education and training programs, NASA space programs, and NIH and NSF health and science research. Spending in virtually all domestic discretionary categories has declined as a percentage of GNP over the last ten years; only the administration of justice and the science and space function have seen increases (the latter very small and very recently). Thus, it would not be accurate to assign the substantial growth of the deficit as a percentage of GNP over the last decade to domestic discretionary spending.

Domestic discretionary budget authority is capped for FY 1993 by the Budget Enforcement Act at about $6 billion to $8 billion below an inflation-adjusted level of spending; outlays will be similarly restricted. The combined discretionary spending cap for FY 1994 and FY 1995, covering defense, international, and domestic spending, will require virtually constant total nominal

spending -- with little or no allowance for inflation. These limits were imposed to provide the last round of savings from the 1990 budget summit agreement. Though the domestic discretionary area has been restrained substantially since 1980, the Committee recognizes that further savings will be needed.

The Committee calls for combined domestic and international discretionary savings of between $13 billion and $20 billion in 2001, and cumulative savings through 2001 of between $70 billion and $100 billion (including streamlining savings specified above).

Savings in defense, international and domestic discretionary spending could be enforced through discretionary spending caps, and could be achieved by targeting low-priority programs for reduction or elimination, freezing spending in certain areas, and streamlining government pursuant to the reorganization and management proposals defined above. Within these discretionary totals, priorities should be adjusted to allow for selected increases in important programs not included in the investment areas (such as crime and drug-abuse programs) as long as overall spending stays within the total constraints.

There are several possible broad strategies to achieve these savings. Some domestic discretionary programs -- including some in natural resources, transportation, and community development, among other functions -- have

primarily local benefits. Those programs where the national interest is found to be limited might be targeted for savings. At the same time, many State and local governments are under considerable fiscal pressure from the current recession, and from the rapid economic change of the past decade. If the economy does not recover soon, there may be need for temporary, targeted and efficient fiscal assistance from the Federal government to assure the delivery of essential public services.

Other programs that deliver benefits primarily to the middle class or to business might be considered desirable but impossible to finance in the current strained budgetary environment. Finally, all policy makers would agree to the reduction or elimination of programs with low cost-effectiveness.

Several domestic discretionary categories would be the focus of targeted investments described below. The Committee's specific initiatives, which concentrate resources on education, health and nutrition, and growth investments, would be paid for, and the discretionary cap would be adjusted to accommodate them.

C. Entitlement Spending

The nature of the problem. Perhaps the most important cause of the long-term growth of the deficit is Federal health entitlement costs; all other categories of spending -- including the other entitlements -- are projected merely to keep pace with, or fall noticeably behind, the growth of the economy.

COMPARISON OF GROWTH IN FEDERAL SPENDING PROGRAMS

(Outlays in billions of dollars)

	FY 1992		FY 2001		Annual % Growth	
	$$	% GNP	$$	% GNP	Nominal	Real
Entitlements	683	11.5	1,288	12.8	7.3	3.8
Health	189	3.2	517	5.1	11.8	8.1
Retirement	352	5.9	592	5.9	6.0	2.5
All Other[1]	142	2.4	179	1.8	2.6	-0.8
Discretionary Programs . . .	549	9.2	696	6.9	2.6	-0.7
Net Interest	208	3.5	352	3.5	6.0	-0.7
GNP (for reference)	5,939	100.0	10,071	100.0	6.0	2.6

[1] Excludes offsetting receipts, deposit insurance, and "credit liquidating accounts".

The need for entitlement reductions. Given this rapid growth, the Committee agrees that entitlement savings are an essential part of deficit reduction. Specifically, the Committee agrees that sufficient entitlement cuts should be implemented to achieve annual savings of $55 billion to $105 billion below current law (that is, below the baseline) by FY 2001. If phased in gradually to minimize dislocation, such cuts would generate cumulative savings of $200 billion to $400 billion over the decade.

The Committee considered three basic questions in approaching the issue of entitlement spending:

1) Should it recommend budget policies to cut entitlements, or should it recommend budget enforcement procedures to force future policy cuts in entitlements? The Committee chose to recommend both policies and procedures, but to emphasize that the underlying goal is long-term, permanent deficit reduction, however it is achieved.

2) Should the recommended policies/procedures focus exclusively on health entitlements, or cover all entitlements? While the Committee's focus is on health entitlements, the Committee believes that other options also deserve debate and that no area should be off the table. However, for perspective, the Committee notes that the maximum savings specified here would total approximately $100

billion over the first five years and another $300 billion over the next four; the health-care savings estimated to result from the 1990 budget summit agreement, which were extremely controversial, came to about $45 billion over the first five years.

3) As part of enforcement procedures used in implementing entitlement cuts, to what extent should committees have the option to substitute revenue or user fee increases? The Committee believes that a reconciliation target may validly be met through any legislative means within a committee's jurisdiction. However, this Committee prefers that all choices be guided by the policy considerations below.

Policy considerations. The Committee considered a large number of specific policy options:

1) With respect to **health care**, the Committee notes that the total suggested savings, if taken solely from the health entitlements, could be achieved only with (a) substantial efficiencies through comprehensive reforms; or (b) significant reductions of access (possibly including increases of out-of-pocket costs) to the elderly and poor beneficiaries of Medicare and Medicaid.

Within the broad confines of the existing programs, Committee Members differ on the potential for achieving efficiencies of this magnitude. Some Members

believe that Federal health programs, or the health care system in general, include significant costs that do not contribute meaningfully to the well-being of beneficiaries. Such costs would include "defensive medicine" to fend off malpractice suits; other low-payoff procedures performed to increase billings; and treatment that extends life without improving its quality. These Members believe that savings can be achieved through tort reforms aimed at the costs of malpractice suits, identification and disallowance of low-benefit procedures, and health care budgets that allow only the most useful treatments to be delivered. Other Members believe that malpractice is a small element in the costs of Federal health care programs; these Members are less optimistic that low-benefit procedures can be identified, and that society can come to refuse even high-cost treatments when there is some chance of benefit to the patient.

In general, the Committee assumes that by the end of the decade there should and will be comprehensive health care reforms. This would increase some costs, by providing health care to the millions who are currently uninsured; but could decrease other costs through administrative efficiencies of fewer payors and payment standards, and possibly through cost control exercised by the Federal Government as a major payor. The Committee recognizes that such reform may reduce the level of Federal costs, but not necessarily the underlying long-term growth rate of those costs, depending on the precise nature of those reforms and of aspects of the health-care market that are not yet fully understood. If the

growth rate of costs is not reduced, demographic pressures may reassert themselves in rising costs in the future regardless of the savings achieved in the next decade.

Despite these uncertainties, the simple arithmetic, embodied in the previous table, causes the Committee to conclude that the long-term growth rate of Federal health care costs must be reduced. Over the last decade, medical care inflation outpaced general inflation by an average of 2.5 percentage points per year. The Committee notes that reducing the annual real growth of health entitlement spending by about that 2.5 percent per year, from 8.1 percent to 5.5 percent, would save the maximum target of $400 billion over the decade.

In addition, a broad national health care plan might -- depending on its nature -- subsume or change Federal health care provided through existing discretionary appropriations.

2) With respect to **retirement programs**, the Committee notes that Federal retirement costs are a stable percentage of the GNP, and therefore are not the primary cause of entitlement spending growth as a percentage of GNP in the next ten years. When the baby boom generation retires, however, the picture will be different; and the deficit is large enough that legitimate savings should be pursued wherever they are found.

Because life expectancies are increasing, a typical worker might receive retirement checks for one-third (or more) of his adult life by the end of this decade. The Committee notes that the Social Security reforms enacted in 1983 increased the retirement age for full benefits from 65 to 67 over a phase-in period starting in the year 2000. The Committee believes that similar savings can be achieved in the other retirement programs by delaying the age at which Federal retirement benefits would first be paid (or at which full benefits would be paid), even without increasing the age (or years of service) at which benefits vest. However, changes must be phased in slowly to accommodate employees near the current retirement age who have no opportunity to adjust their plans, even if it postpones significant savings to well beyond a ten-year horizon. Further, Federal retirement is part of a compensation package that must be competitive to attract quality workers; any potential change must be studied carefully, especially in light of the rapidly changing personnel needs in the military.

Another well known option, reducing or postponing cost-of-living adjustments (COLAs), seems simple and equitable; but COLA cuts hit the poorest beneficiaries, and affect only current retirees (and not those who retire after the cut, who could be expected to be better off) and therefore yield only temporary deficit savings. The Committee believes a better alternative that protects the poor and near-poor, treats current and future retirees the same, and achieves permanent savings is to provide tax treatment of Social Security similar to that of other

pensions, in which past contributions that were subject to income tax are recovered tax free, but all other benefits are taxed in full. Such an approach should continue protection of the low-income elderly.

3) Means-testing of benefits through income taxation could be applied to Federal health care costs (and other programs, such as Veterans benefits, subject to careful study). One possibility is to treat as taxable income the average insurance value of Federal health care (after recovery of Medicare payroll taxes paid). Another, as proposed by the administration, is to condition the Medicare Part B premium on the level of income.

4) Because the other entitlements category is shrinking to only 14 percent of all entitlement costs by FY 2001, it can be only a small part of overall cost savings. Further, the Committee notes that most of these are safety-net programs such as AFDC, SSI, and Food Stamps, which (along with Unemployment Compensation) cushion hardship and have an important counter-cyclical fiscal effect. Still, other programs in this category, such as farm price supports, veterans compensation, housing programs, and student loans, benefit the middle class or businesses. Savings can be achieved by targeting resources to those with the greatest needs. Work incentives to recipients of income support programs might yield significant budgetary and social benefits. Any changes in farm price supports

must be tied to negotiations in the General Agreement on Trade and Tariffs (GATT), and probably implemented in the 1995 amendments to the Farm Bill.

The dollar target. While $200 billion to $400 billion in ten-year entitlement savings is an ambitious goal, the Committee believes it is achievable. Holding medical-care inflation to the rate of growth of prices in the economy at large would, by itself, achieve $400 billion in savings. The other options could substitute for part of those savings; at least $200 billion could be generated entirely apart from health care.

Process enforcement considerations. The Committee recommends the design of a cap, enforced through the budget process, on the growth of entitlement programs, in order to reduce their underlying growth rate to a sustainable figure. If that growth rate can be restrained permanently, the deficit problem in the entitlement area can be controlled. If not, all alternative sources of deficit reduction (defense cuts, domestic discretionary cuts, taxes, or use fees) will sooner or later be exhausted, and the deficit will resume its inexorable climb.

While the Committee believes that an entitlement "growth cap" tied to a mandatory reconciliation process can be designed, it recognizes that there are myriad technical issues that must be resolved to make this concept workable. The most difficult tasks in the design of the process are (1) establishing accurate caps

in a timely fashion so that the desired savings are achieved, low-income programs are protected, and the Congress and the program administrators have adequate time to achieve them in the most efficient way; and (2) allocating the required savings appropriately among the committees, and allowing them to use all the legislative means within their jurisdiction to achieve those savings.

Conclusion. Entitlement programs are very sensitive in both a political and a policy sense. The medical care entitlements are extremely so; they are important to practically every American, because they potentially affect an individual's very life. However, the size and growth of the medical care programs has become such that controlling their costs is inevitable. The longer that control is delayed, the larger a health care industry predicated on the current programs becomes, and the more the expectations of potential beneficiaries become ingrained; and so, the greater the pain of the eventual adjustment.

The concept of an entitlement cost cap is strongly endorsed by the Committee; and it deserves to be examined, carefully defined, and ultimately enacted.

D. Revenues

No Member of this Committee relishes the contemplation of additional taxes, particularly in a recessionary economy. Thus, the focus of the Committee was on savings in entitlements, defense and other discretionary programs. The view was that revenues, if they were to play a role in this strategy, would be targeted in specific payment for the tax cuts or growth investments specified below. However, with $1.0 trillion to $1.5 trillion of budget savings required just to reach the deficit reduction goal, the reality is that a shortfall of spending savings in any area would require either deeper cuts elsewhere or increased revenues, or a combination of both.

The Committee considered a long list of potential revenue-raising steps during its briefings and caucuses. However, the current political debate focuses on tax relief for middle-income families and tax incentives targeted to increased economic growth. Revenue-raising steps are being considered mostly to pay for such initiatives, rather than for deficit reduction.

3. Investments in Economic Growth

A majority of the Committee believes that the long-term health of our economy and well-being of our people are dependent not only on restoring resources through deficit reduction but also on investing in ways that will promote greater growth and security within our society as well. The Committee is concerned about increasing evidence that important segments of our economy and society are suffering:

- Our education system fails too many of our children, leaving them inadequately prepared for either the world of work or higher education;
- Too many of our people, including many working families, suffer from inadequate health care, and poor nutrition;
- Combining the above, too many children, handicapped by inadequate nutrition and health, and provided with no preschool support, are destined to fail when they enter the public education system; and
- Our public sector does not provide the private sector with the prepared workforce, the scientific and technological base, and the infrastructure that it needs to achieve rapid productivity growth.

A majority of the Committee recommends that investments in these areas be an inherent part of a pro-growth package that includes deficit reduction. This combination -- deficit reduction, which will facilitate private investment; and

targeted public investment in the needs of our society -- is the best possible contribution to our long-term economic strength.

A. Education

Our elementary and secondary school system is not preparing American youth to achieve world standards for either higher education or the workplace. The Nation has agreed to a set of education goals: that children enter school ready to learn; that the high school graduation rate increase to 90 percent; that students achieve mastery of basic subject matter; that students achieve world primacy in math and science; that we end adult illiteracy; and that drugs and violence be removed from our schools.

To achieve these goals, the Committee recommends that we target resources to the following programs:

- Head Start. Many low-income children begin elementary school behind, and never catch up. Head Start -- quality developmental preschool care for low-income children -- has been demonstrated to improve school performance, reduce school problems, and yield long-term benefits well in excess of its cost. Full funding of Head Start would provide the early help that many educators agree would offer the best chance to turn lives around.

- Even Start. Even Start teaches literacy skills to disadvantaged children (ages 1-7) and their parents at the same time. Even Start is a relatively new program, but studies of similar programs have indicated that literacy training for parents reinforces their children's learning.

- Compensatory Education. Chapter 1 compensatory education helps educationally disadvantaged elementary and secondary students, most from poor families. These students improve their math and reading test scores relative to similar students who do not participate. Today, however, only about 65 percent of educationally disadvantaged children are served, including 70 percent of eligible elementary school children and 40 percent of secondary school children.

- Education for Children with Disabilities. Federal law mandates that states and localities serve increasing numbers of children with physical and learning disabilities. Follow-up studies have shown progress by the disabled participants and reduced subsequent education costs. The Federal share is currently 7 percent of the average excess per pupil cost; a 40 percent share is authorized under current law.

- Math/Science Education. Mathematics and science education responds directly to the national goal of world leadership. Both the Department of

Education and the National Science Foundation (NSF) should do more to support efforts to improve math and science education.

- Vocational Education. According to the GAO, about 9 million of the nation's 33 million 16 to 24 year olds in 1988 -- 5.5 million dropouts and 3.8 million high school graduates -- did not have skills needed for entry level jobs. Academic education does not serve these youth, and existing vocational education programs are ineffective and outmoded. Apprenticeships, cooperative education, "tech prep" and other innovative vocational education programs must be created, expanded and improved.

- Financial Aid to Higher Education Students. Financing higher education is increasingly difficult. While Federal funding for Pell grants increased by 36 percent in real terms between 1980 and 1991, the costs of postsecondary education increased faster; Pell grants now average only one-third the cost of a four-year public college.

These programs have been chosen for investment because they have track records of cost effectiveness, and because they address crucial needs in the existing educational system. They would be unlikely merely to substitute for existing state and local government efforts, because they address problem areas that states and localities have tended to give limited emphasis in the past.

Some analysts have argued that the problem with our educational system is not the level of funding, but its structure. They have responded with proposals such as increased school choice on the part of parents, or financial incentives from government based on school performance. Opinions differ on the merits of such restructuring. However, the programs targeted here are complementary to any approach to school structure.

B. Health Care

At least 33.4 million Americans are without health care insurance coverage; over 80 percent are members of families where there is a working adult. As many as 60 million persons may be without coverage for some period over the course of a year. Another 10 million persons have coverage that would be inadequate for a catastrophic illness. At the same time, health care spending is increasing faster than the economy, and consumes more of our GNP than does health care in other industrialized nations.

When some Americans are unable to afford health care, every American suffers. The uninsured themselves are less likely to receive care and are one to three times more likely to die when hospitalized. Those with health insurance must pay more to cover the uncompensated care for the uninsured. In fact, hospitals

provided $10.7 billion of uncompensated care in 1988, or two percent of total personal health care spending.

The Committee believes that comprehensive health care reforms will be adopted after careful study within the next ten years. These reforms should be financed in a deficit-neutral fashion.

In the interim, the Committee recommends that we target resources to:

- WIC. WIC provides nutrition and counseling for pregnant and nursing mothers and their young children. WIC is proven to reduce low birthweight, infant mortality, and premature birth. Participating mothers have been found to improve their diets and health practices, including seeking early prenatal care and immunization for their children. WIC has been found to pay for itself up to three times over within sixty days of birth, especially through decreased costs of intensive care of premature and underweight infants. WIC serves only half of those eligible. Full funding of this program is essential.

- Immunization. Childhood immunization has reduced the incidence of many diseases, and saved more than its cost in reduced subsequent treatment. However, complacence has reduced immunization; six million children are

not immunized, and the incidence of immunizable diseases has increased. We recommend immunizing all school-aged children, both through existing programs (Centers for Disease Control (CDC); Community and Migrant Health Centers; and the National Health Service Corps), and a new program: outreach through preschools and elementary schools, and through mobile facilities. Such outreach can build on new research on medical screening to provide other preventive care; influenza immunization for the elderly; and "one-stop shopping" to inform families of other services available to them.

- Other nutrition programs. We recommend passage of the Mickey Leland nutrition bill and expansion of the school breakfast program to target nutrition assistance to poor families with children. A recent survey revealed that one in eight U.S. children suffers from hunger.

- Residential treatment of addicted pregnant women. We would provide treatment away from destructive home environments for addicted pregnant women. Such treatment can be cost effective, in that women can recover to lead productive lives, and premature births can be averted. Underweight infants who can require the most costly medical treatment -- even more costly than heart transplants -- can be born without disabilities through early intervention.

As with the education investments, these health programs were selected because they have a demonstrated record of cost-effectiveness.

C . Workforce, Technology and Infrastructure Investment

American business should not be handicapped by an inadequately prepared workforce, crumbling infrastructure, and less public investment in scientific and technological knowledge than in our competitor nations. The Committee recommends targeting resources to the following programs:

- Job skill training. Job Corps currently can serve 68,000 students; it targets the approximately 440,000 most "seriously at-risk" youth, though an estimated five million are eligible for the program. The average Job Corps student is an 18-year-old minority high school dropout who reads at the seventh grade level, has never held a full-time job, and comes from a family with an annual income of $5,355. Job Corps provides intensive academic and vocational training, has been shown to be cost-effective, and has a placement rate in the private sector or in college of 84 percent. Expanding capacity by 150 percent would allow training of all 440,000 seriously at-risk youth over less than three years. Also, Federal adult education programs provide formula grants to the States to serve four million of the estimated 30 million adults who lack the most basic literacy skills. Nationwide, all

public and private literacy programs serve about 19 percent of those who need help. These, too, should be targeted.

- Infrastructure. Recent studies indicate that the Nation's physical infrastructure, particularly highways and mass transit, will not meet future needs. The expected increase in highway congestion of 300 percent to 400 percent by 2010 would impose a $30 billion annual cost from delays. Airline passenger loads more than doubled between 1973 and 1988. In addition, recent Federal mandates for clean air and access for Americans with disabilities pose a cost burden for states and localities. The Committee recommends targeted resources for highways, mass transit and aviation, including innovative technologies such as high-speed rail (both magnetic levitation and steel-wheel) and intelligent highway vehicle systems. While a recent CBO report concludes that high economic returns come only on carefully selected projects, such projects can yield reduced costs from congestion, environmental pollution, and accidents. Infrastructure efforts should be expanded to include rehabilitation, repair and maintenance of public housing.

- Research. The National Institute of Standards and Technology (NIST) undertakes generic technology research and performs extension services similar to those traditionally performed by agricultural extension. The United

States is weaker in the development and dissemination of technology than it is in science, and does less in these areas than the governments of our major competitor nations. The NSF provides grants for science and engineering research, and also supports math and science education. Research by the National Institutes of Health (NIH) contributes to the pharmaceutical and biotechnology industries. It has been recommended that the research and experimentation (R&E) tax credit be made permanent.

- Energy. Research into production and renewable fuels; promotion of energy conservation and the use of alternative fuels; and increased capacity and oil contents for the strategic petroleum reserve would increase U.S. energy security.

- Environment. We recommend funding and management reform to accelerate Superfund cleanup and containment; meet water quality standards; increase land acquisition, conservation, and environmental research; and implement current environmental laws and regulations.

- Microenterprise. "Microenterprise" self-employment assistance and incentives for disadvantaged persons and/or in economically lagging localities shows promise of increasing business formation and decreasing welfare costs.

D. Tax Relief and Incentives

- Middle-income tax relief. Some Members of the Committee favor deficit-neutral tax relief for middle-income families. These Members believe that real wage growth has been sluggish for a number of years; this has had a particularly burdensome effect on the typical American family, which has to work for virtually all of its income. Though some recent changes in the tax code when viewed individually have been favorable for working families, all changes taken together have achieved little net reduction in the percentage of these families' incomes that is paid in tax. Particularly burdensome have been increases in the payroll tax, which bears most heavily on low-income working people. Tax relief could be delivered through the income tax, though it might be keyed to payroll tax payments; alternatively, the relief might be based on the presence of children in the household. The Committee believes that tax relief must be paid for because any long-term increase in the deficit would inhibit domestically financed private investment, and therefore would reduce future incomes. The compensating deficit reduction might be allowed to lag behind the tax relief, however, to provide some countercyclical fiscal stimulus in the first year to combat the current recession.

- Tax incentives for investment. Some Members of the Committee favor tax incentives for investment. The Committee considered a variety of incentives for different forms of investment and saving, including investment tax credits, acceleration of depreciation deductions, indexation of depreciation deductions for inflation, indexation of capital gains for inflation, reduced tax rates for capital gains, and liberalized individual retirement accounts. Each produces mixed results depending on its specific design. Without choosing the particular policies, the Committee recommends that such incentives be targeted, paid for, and focused on the long term.

Other high-priority investments. Other high-priority investment areas, to be protected at least at baseline levels, include anti-crime and anti-drug programs. Also, if the economy does not recover soon, temporary, targeted fiscal assistance to State and local government should be seriously considered.

Possible Total Funding for All Investments

While it is difficult to project a firm figure for these investments, particularly the revenue loss associated with various tax relief proposals, the cost could range from $300 billion to $370 billion cumulatively over ten years, within the constraint of the overall deficit reduction target. Again, it is important to stress that these investments must be paid for through additional spending savings or targeted

revenue increases. The Committee believes that deficit reduction and adequate public investment must be combined to provide a true growth strategy for the U.S. economy.

CONCLUSION

As this report is being written, the President, the Congress, and the two parties are seeking the means to a quick recovery from the current recession, something that we all desire. Unfortunately, too much of the debate that is taking place is partisan in nature, and, more importantly, too much of the debate is focusing on the short term.

If there is any single message above all others that this Committee wishes to convey to our colleagues in the Congress, to the President, and to the Nation, it is this: Now is the time to raise our eyes to the horizon and seek to restore our nation's future. Our goal should not be a quick fix with short-term and perhaps illusory effects. Rather, we should aspire to enact future-oriented policies that lay the foundation for strong, consistent economic growth and a better society that can directly improve the lives of our children and grandchildren.

In the 1980s, the Nation thought only about the 1980s. In the 1990s, we are harvesting the bitter fruit of that decade's public and private excesses. What was absent from leadership was the foresight and ability to look beyond the next day's headlines.

The danger today is that in the headlong rush to find a politically expedient response to a sluggish economy, the mistakes of the 1980s will be repeated.

The Committee is convinced that the American people understand the depth of the economic and societal problems that they confront, and are prepared for bold action. The Committee believes that action must be guided by its effect on the Nation and the American people over this next decade and beyond.

If we are to restore public trust, the question we must be able to answer is not, "What have you done for me lately?" as we too often think. The question at the heart of the American people's concern is, "Is the American dream still a reality, for myself and for my children?" That is a question that demands more than a quick fix. It demands the kind of vision we have sought to provide in this report. Guided by that vision, the Committee believes that we can restore confidence in the American dream and in America's future.

PROJECTED DEFICITS RETURN TO $300 BILLION LEVEL BY 2001

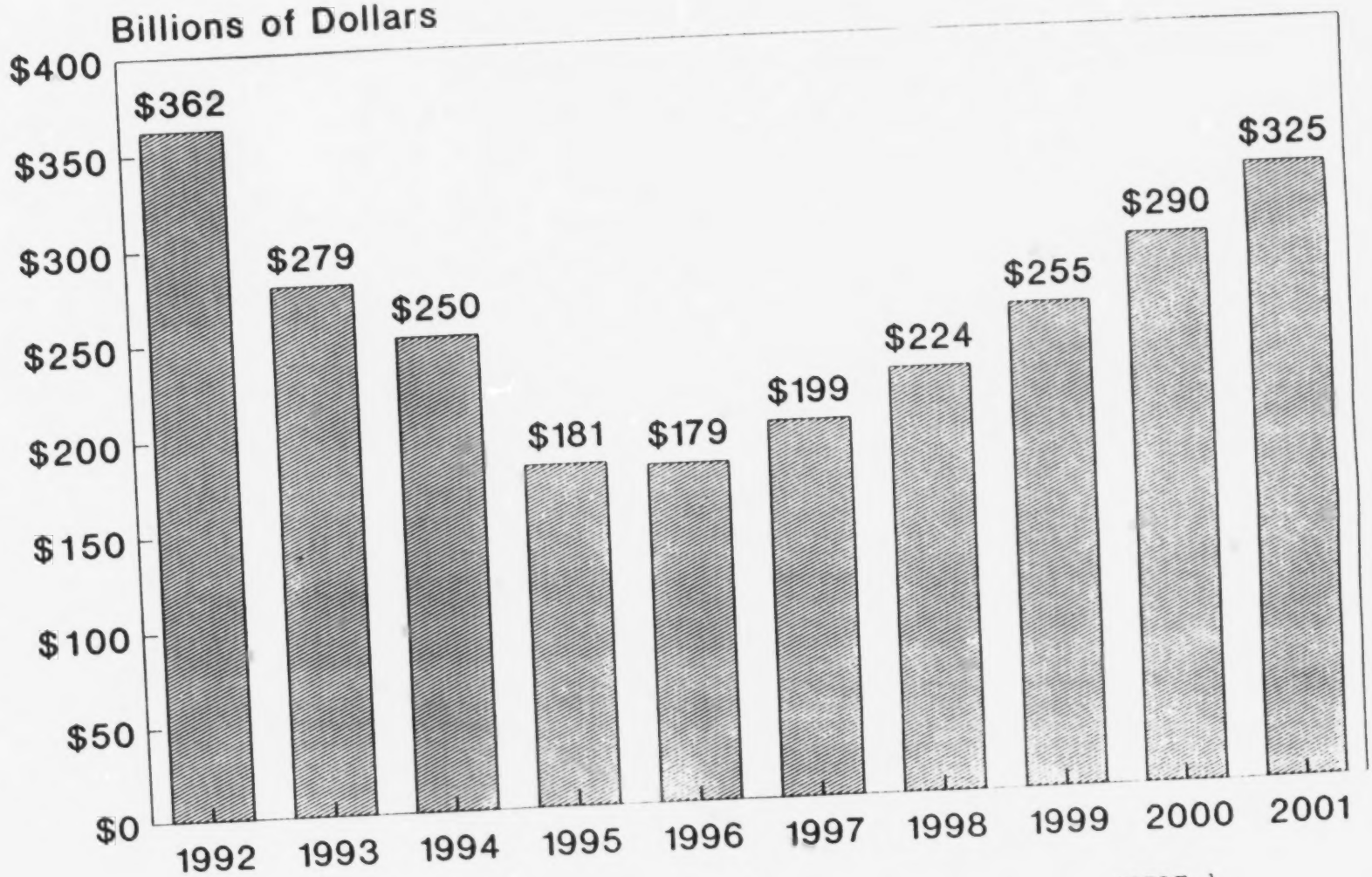


TABLE 1

HBC Baseline

THE HBC BASELINE

Baselines are projections of current tax, entitlement, and appropriation law into the future. The purpose of a current policy baseline is to be a benchmark against which policy proposals can be measured. For revenues and entitlements, the HBC baseline follows rules specified in the Balanced Budget and Emergency Deficit Control Act, under which tax and entitlement law is estimated, year-by-year into the future, based on the provisions of law effective for that year (with a few exceptions specified in BBEDCA).

For discretionary programs, the HBC baseline is as follows: 1) For defense, the administration's budget (CBO estimate) is assumed. Those figures extend through Fiscal Year 1996, after which inflation adjustments are assumed (which is the administration's stated policy). 2) For international and domestic programs, the HBC baseline assumes the BBEDCA's statutory caps in Fiscal Year 1993, and inflation adjustments thereafter.

In contrast, CBO's August baseline assumes that discretionary funding will equal BBEDCA's statutory caps through Fiscal Year 1995, when they expire, and will grow with inflation thereafter. But in CBO's baseline, specific figures for defense, international, and domestic programs disappear after Fiscal Year 1993, when the "sub-category walls" expire. Therefore, CBO's baseline cannot serve as a benchmark for policy in those areas. In summary, the HBC baseline equals the CBO baseline in Fiscal Year 1993 but is greater in later years, when the aggregate cap (which CBO assumes) is more restrictive than the sum of the administration's defense policy and the inflation-adjusted Fiscal Year 1993 cap level for international and domestic programs (which HBC assumes).

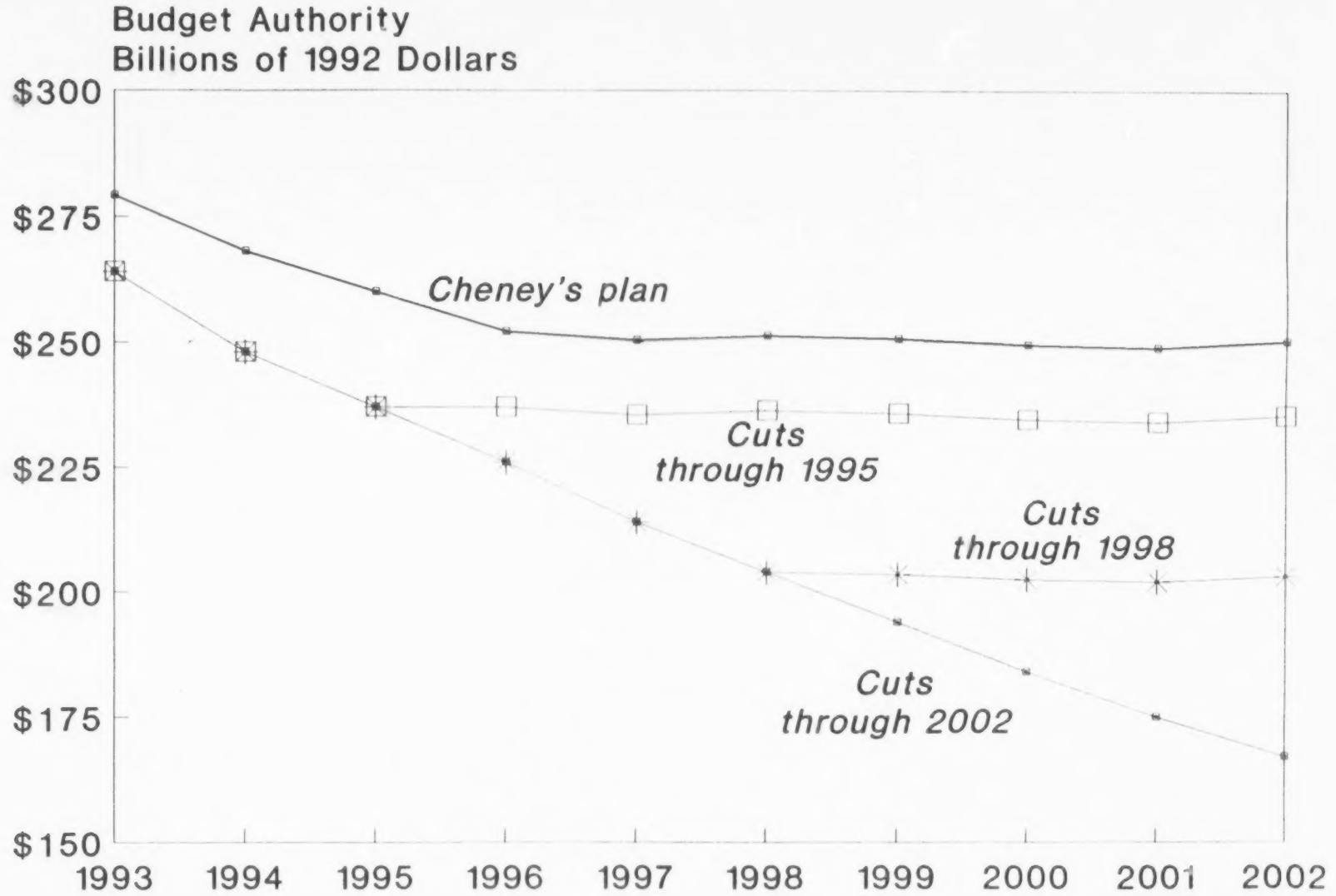
HBC baseline (using CBO economic and technical assumptions)
(dollars in billions)

	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
HBC BASELINE OUTLAYS:										
Discretionary:										
Defense (1).....	314	295	292	292	297	301	313	325	339	353
International (2).	20	21	22	23	24	25	26	27	28	29
Domestic (2).....	215	225	239	250	261	271	281	291	303	314
Subtotal(3)....	549	541	553	565	582	597	620	643	670	696
Entitlements.....	694	740	787	839	895	962	1032	1111	1196	1286
Deposit Insurance....	115	58	32	-32	-44	-31	-23	-16	-13	-10
Offsetting receipts..	-63	-66	-70	-73	-75	-80	-84	-89	-93	-97
Net Interest.....	208	229	247	259	270	283	297	313	332	352
TOTAL OUTLAYS.....	1503	1502	1549	1558	1628	1731	1842	1962	2092	2227
HBC BASELINE REVENUES...	1141	1223	1299	1377	1449	1532	1618	1707	1802	1902
HBC BASELINE DEFICIT....	362	279	250	181	179	199	224	255	290	325
Addenda:										
HBC Def. w/o deposit ins	248	221	218	213	223	230	247	271	303	335
as % of GNP.....	4.2%	3.5%	3.2%	3.0%	3.0%	2.9%	2.9%	3.0%	3.2%	3.3%
CBO baseline deficit....	362	279	234	157	156	182	208	238	269	303
HBC def. vs. CBO def....	0	0	16	24	23	17	16	17	21	22
Off-budget surplus(4)...	63	70	83	95	106	120	133	149	166	185

(1) Administration budget as reestimated by CBO. Administration assumes zero real BA growth after FY 1996.
(2) FY 1993 figures equal the caps. Thereafter, the figures grow with baseline inflation.
(3) The defense/non-defense total EXCEEDS the total outlay cap by $14 billion in FY 94 and $21 billion in FY 95.
(4) Social Security and Postal Service.

TABLE 2

POSSIBLE DEFENSE PATHS



ADDITIONAL VIEWS

OF THE

HONORABLE BILL GRADISON

Statement of

REPRESENTATIVE BILL GRADISON

Ranking Republican, House Budget Committee

in response to the Chairman's Report on the Budget, the Economy, and the Society

December 12, 1991

Introduction

Looking at the Federal budget with a ten-year perspective has been a useful, instructive, sobering and, at times, daunting exercise. As the Chairman's report indicates, Budget Committee members from both sides of the aisle have learned a great deal from the undertaking. Broad agreement was apparent on the following points:

- Even with a return to "normal" economic growth, the Federal budget deficit will not disappear or even diminish appreciably over the coming decade under current budget policies.

- Moreover, sharply reducing the Federal budget deficit is a prerequisite to raising long-term economic growth.

- The budget deficit should be reduced through *spending restraint, rather than through tax increases*.

- Dealing with entitlement spending is crucial to controlling Federal spending and permanently reducing the deficit.

- No easy answers, free lunches, or magic bullets can replace the difficult task of reining in government spending to fit the national pocketbook -- or the tough political decisions that task will require.

There is disagreement, however, over the following fundamental issues:

- It should be possible over a decade of determined effort not only to eliminate the Federal budget deficit, but to achieve an annual surplus equivalent to the excess of the Social Security Trust Fund. Condoning a deficit goal, ten years from now, of even 0.5 percent of Gross National Product (GNP) is not good enough -- especially considering the track record of Congress and the Administration in achieving their budget goals.

- By 1996, defense budget authority will have been reduced by one third since 1985. Budget policy should not hinge primarily on further deep cuts in the shrinking U.S. defense budget -- and any additional cuts should be based on *demonstrable* changes in defense requirements.

- The 1990 budget agreement is barely a year old. Sixty percent of its savings are not scheduled to occur until Fiscal Years 1994 and 1995, the last two years of the five-year strategy. Regardless of how illuminating a ten-year perspective might be, it should not become a distraction from the difficult task of meeting the budget agreement's deficit targets in the next three years.

- Discussion of a ten-year budget strategy should not be the platform for a new layer of election-year domestic spending, no matter how well intentioned or how attractively labeled. New or increased investments, if needed in certain areas, should be funded with resources currently devoted to other domestic discretionary and entitlement spending.

These differences do not overshadow the broad agreement among Committee members about the nature of the problem. To the extent that the views below disagree with the Chairman's, it is because the Chairman's analysis is taken seriously. Politics at its best involves vigorous debate between parties with differing views about how to meet the problems of the day. Such discourse is healthy and necessary, and -- when it works well -- echoes the deeply held convictions of those who care enough to engage in it. It is in this spirit that these views are presented.

The Economic and Deficit Outlook

The points in the Chairman's report concerning the economy and the deficit are worth re-emphasizing.

The deficit is a major threat to the long-term health of the economy. Continued government borrowing on anywhere near the current scale will slow any potential improvement in living standards. These effects will not be sudden, dramatic, or even especially recognizable when they occur. Instead, they will take hold slowly and inexorably. They will accrue over time, and the cumulative damage to the economy will be significant.

Robert D. Reischauer, Director of the Congressional Budget Office, recently described the deficit impact in the following way:

> Large budget deficits reduce national saving by absorbing part of the funds businesses and households set aside -- funds that would otherwise go largely into productive investment in the private sector of the economy.

> Expanded productive capital is one of the best-understood sources of economic growth. Reducing the deficit, as long as it does not impair Federal spending for public investment, will expand saving and capital formation, reduce borrowing from abroad, and increase the rate of growth of U.S. standards of living.
>
> . . . Both private and public saving have shrunk as a percentage of Gross National Produce (GNP) in the last decade. The sum of real private and public saving as a share of GNP averaged 7.3 percent from 1952 through 1979, but plummeted to 2.9 percent in 1980 through 1990. The Federal Government bears a large part of the responsibility for this drop in saving. On a national income and product accounts basis, the budget deficit, which averaged 0.9 percent of Gross National Product from 1952 through 1979, swelled to 3.7 percent of GNP in the 1980-1990 period.
>
> The analysts at the Federal Reserve Bank of New York find that the drop in saving during the 1980s has already reduced the productive capacity of the U.S. economy by about 5 percent. If the current low level of saving continues, the researchers estimate that the loss in potential GNP will grow to 10 percent by the end of the decade.[1]

The Chairman also is correct that large deficits hamstring the Government, restricting its ability to address pressing needs. Indeed, this already is the case. For this reason, a deficit reduction plan must defer spending and tax initiatives that add to the deficit until the budget is under control.[2]

But deficit reduction can have a negative impact on the economy in the short run. Reducing government spending by 4 percent to 6 percent of GNP -- even if spread out over five or ten years -- can depress economic activity. The recent recession and slow recovery can be traced partly to the tax-increases employed to reduce the deficit in the Omnibus Budget Reconciliation Act of 1990.

But that is not a reason for backing down from the budget agreement and the long-term benefits of deficit reduction. Here again, the Chairman's point is correct: the long-term health of the economy must take precedence over short-term economic stimuli. Deficit reduction should be the focus of Congress's efforts.

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1 November 6, 1991 testimony before the Legislation and National Security Subcommittee of the House Committee on Government Operations. The Federal Reserve research cited was published in "The Decline in U.S. Saving and its implications for Economic Growth," Federal Reserve Bank of New York Quarterly Review, vol. 15 (Winter) 1991, pp. 1-19.

2 This is not to suggest that a balanced budget would allow Congress to spend all the money it wanted to. Federal resources are always finite, so policy makers will always have to choose which of their priorities should be funded. The deficit, and its effects on the economy, merely make such decision-making that much more critical.

Budgetary Assessments

1. The Difficulties of Long-Range Budgeting

Though it may be enlightening to assess the long-term impact of current fiscal policies, trying to budget for the long term can invite unnecessary frustrations and failures.

To begin with, few economists will stake their reputations on projections farther than a year or two into the future. Budgets based on five-year projections, therefore, are ambitious. Planning fiscal policy for a decade is, at best, chancy.

Another difficulty is the pace at which national priorities change. The defense buildup on which much of President Reagan's reputation stood lasted just four years, ending in 1985; defense spending in real (inflation-adjusted) dollars has declined ever since. Similarly, universal deductibility for investments in Individual Retirement Accounts also was in place for only four years. The anti-poverty Office of Economic Opportunity was established in 1965, and by 1970 its demise was in sight. The Chairman's emphasis on areas such as education, nutrition, and health care is understandable. But it is uncertain what different kinds of demands, domestic or international, might impose themselves on Federal spending priorities two years from now, much less eight years or ten.

The long-term strategy also risks complications from its interlocking design. No matter what kinds of flexibility might be worked into the program, a long-term budget has to assume certain trends in broad areas. If any one of these trends cannot be maintained, it affects all the others.

Finally, a ten-year budget must endure through ten sessions of Congress and at least three Administrations. One Congress cannot require a succeeding Congress to uphold its decisions. Some Congresses cannot bind even themselves to their own plans when the time to vote on specifics arrives. Long-term plans also tempt Congresses to adopt the attractive, popular, and often expensive initiatives while postponing the unpopular, cost-saving decisions in hopes that a new plan will come along before any tough choices have to be made.

In short, pursuing long-term goals, and examining fiscal projections over five or ten years, are worthwhile enterprises. But unless Congress is willing to adopt formal multi-year spending plans – and stick to them – there is no substitute for the hard work of budgeting, choosing priorities within available resources, one or two years at a time.

2. Goals

The Chairman's pursuit of deficit reduction is absolutely right, but it would benefit from a more rigorous goal. Instead of targeting $1.0 trillion to $1.5 trillion of deficit reduction, and still leaving intact a deficit of 0.5 percent of GNP, a long-range plan should

seek a budget *surplus* roughly equivalent to the excess in the Social Security Trust Fund. If achieved, this balance would actually contribute to national savings, and would establish the groundwork for enduring fiscal control.

3. Defining All the Savings

To the extent that long-range plans are attempted, their projections should be reasonably precise. Suggesting entitlement savings of $200 billion to $400 billion, or defense cuts ranging from $174 billion to $419 billion, is too broad. This is especially true if interest savings are to contribute significantly to deficit reduction.[3] If any of the savings fail to materialize, and the deficit grows, the anticipated interest savings also will fall short.

4. Budget Baselines

As noted above, projecting the path of current spending policies has been instructive. Used in this way, the Chairman's budget baseline makes it clear that the 1990 budget agreement did not go far enough in reducing the deficit.

Unfortunately, the term "baseline" gradually has taken on the notion of a normative standard; spending less than the baseline in a given fiscal year implies a spending reduction -- even though the number of dollars spent from one year to the next increases.[4] Given the hard choices required to eliminate the deficit, it would be better to set aside the baseline concept for purposes of the annual budget exercise. Instead, proposed spending should be compared to the previous year's actual spending.

The process is straight-forward in the case of discretionary programs. Both the budget resolution and the appropriations process lend themselves readily to deciding whether to fund some, all, or more than the costs of inflation.

Entitlement programs can be similarly reviewed. Congress *can choose* whether to cover all the costs of demographic shifts, population increases, inflation, or other program-driven expenses. If these factors cannot be funded fully, the budget resolution can require reconciliation legislation to conform entitlements to available funding levels. In short, entitlement programs can be controlled.

In this context, it is important to note carefully the construction of the baseline used in the Chairman's report. Its particular characteristics define the context of the Chairman's proposed spending increases and reductions.

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[3] The Chairman's report spells out only $919 billion in spending restraint, with the other savings presumably coming from the resulting lower interest costs.

[4] See New Rules for an Old Game: A Background Report on the FY 1992 Budget, by the House Budget Committee Republican Staff, February 1, 1991.

Table 1. Panetta Baseline and CBO Baseline Projections, 1993-2001

(in billions of current dollars)

Panetta Baseline[#] (Outlays)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295[*]	292	292	297	301	313	325	339	353
International	21	22	23	24	25	26	27	28	29
Domestic	225	239	250	261	271	281	291	303	314
Subtotal	541	553	565	582	597	620	643	670	696
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Deposit Insurance	58	32	-32	-44	-31	-23	-16	-13	-10
Net Interest	229	247	259	270	283	297	313	332	352
Offsetting Receipts	-66	-70	-73	-75	-80	-84	-89	-93	-97
Total Spending	1502	1549	1558	1628	1731	1842	1962	2092	2227

CBO Baseline (Outlays With BEA Discretionary Caps)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295[*]	a	a	a	a	a	a	a	a
International	21	a	a	a	a	a	a	a	a
Domestic	225	a	a	a	a	a	a	a	a
Subtotal	541	539	544	563	585	608	633	658	684
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Deposit Insurance	58	32	-32	-44	-31	-23	-16	-13	-10
Net Interest	229	246	257	266	278	291	306	323	342
Offsetting Receipts	-66	-70	-73	-75	-80	-84	-89	-93	-97
Total Spending	1501	1534	1534	1605	1714	1825	1945	2071	2205

CBO Baseline (Outlays Without BEA Discretionary Caps)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	306	316	323	333	344	359	374	390	407
International	21	22	23	24	25	26	27	28	29
Domestic	229	239	250	261	271	281	291	303	314
Subtotal	556	577	596	617	640	666	693	721	750
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Deposit Insurance	58	32	-32	-44	-31	-23	-16	-13	-10
Net Interest	230	249	263	277	293	311	332	355	381
Offsetting Receipts	-66	-70	-73	-75	-80	-84	-89	-93	-97
Total Spending	1517	1575	1592	1670	1784	1903	2030	2166	2310

[a] A single cap covers all three discretionary categories in 1994 and 1995. The caps do not apply after 1995.

[*] Includes outlays for Operation Desert Storm.

[#] Projections in these views start in 1993, the first year in which this report could have an impact.

Source: Congressional Budget Office and the Chairman's Report.

As the report acknowledges, the "Panetta baseline" is a mixture of calculations from the Congressional Budget Office and the Administration. It uses Administration projections for defense outlays through 1995, and then assumes growth at inflation through 2001. For domestic and international discretionary spending, however, the Chairman employs a different standard. He assumes inflationary growth starting in 1993 -- using CBO projections -- even though doing so drives total discretionary spending above the mandated spending caps for 1994 and 1995. (CBO did provide the Committee with another projection of outlays -- included in Table 1 of this statement -- that assumed adherence to the 1994-95 aggregate discretionary spending caps. Total spending levels in this set of figures are lower than those

Table 2. Discretionary Spending Caps and Panetta Baseline Projections
(in billions of current dollars)

Discretionary Caps (Outlays)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending Caps									
Defense	292.5*	a	a	a	a	a	a	a	a
International	20.6	a	a	a	a	a	a	a	a
Domestic	224.5	a	a	a	a	a	a	a	a
Subtotal	537.7	537.7	543.0						

Panetta Baseline (Outlays)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295	292	292	297	301	313	325	339	353
International	21	22	23	24	25	26	27	28	29
Domestic	225	239	250	261	271	281	291	303	314
Subtotal	541	553	565	582	597	620	643	670	696
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Deposit Insurance	58	32	-32	-44	-31	-23	-16	-13	-10
Net Interest	229	246	257	266	278	291	306	323	342
Offsetting Receipts	-66	-70	-73	-75	-80	-84	-89	-93	-97
Total Spending	1502	1549	1558	1628	1731	1842	1962	2092	2227
Amount by which Panetta baseline exceeds discretionary cap	3.3#	15.3	22						

[a]Separate caps for defense, international, and domestic discretionary spending apply for the last time in Fiscal Year 1993. In 1994 and 1995, a single cap is to be applied, covering all three discretionary categories. The caps do not apply after 1995.

*Does not include outlays for Operation Desert Storm.

#The Panetta baseline includes outlays for Operation Desert Storm. Without those outlays, and if totals were not rounded, the Panetta baseline could meet the discretionary caps for 1993.

Source: Congressional Budget Office and the Chairman's Report.

in the Chairman's baseline.) Thus, the Panetta baseline shows the projected effects of current policy in one discretionary category (defense) but not in the others (domestic and international). Again, this inconsistency is important because the Chairman's baseline forms the basis for his long-range spending plans.

5. Keeping Faith with the Budget Agreement

A successful long-range deficit-reduction plan should build on successful budget-control mechanisms, such as the spending caps mandated by the Budget Enforcement Act (BEA). Considering the Chairman's favorable review of the BEA -- a view shared by a majority of Committee members -- it would be appropriate to maintain its disciplines in the long-range plan. This assumption should be reflected in the baseline.

The Chairman's baseline would therefore be a better yardstick if it did not exceed the BEA spending caps (see Table 2 on the preceding page). To reiterate the point: The Chairman's discretionary baseline exceeds the aggregate spending caps in 1994 and 1995; it does so because the Chairman assumes inflationary growth in domestic and international discretionary spending starting in 1993, rather than containing that growth to a level allowed by the caps; and it does so even though defense spending declines in nominal terms. A better approach -- in light of the acknowledged need for deficit reduction -- would be to assume all discretionary spending would stay under the BEA cap in 1994 and 1995.

ENTITLEMENTS

Only one truly critical problem exists in Federal budgeting: entitlements. Defense and domestic discretionary spending could be cut every year, and taxes raised, and the entitlement problem would remain. Indeed, to the extent that Congress pretends it can heap most of its spending restraint on discretionary categories -- and to the extent that Congress thereby delays the reckoning with entitlements -- the problem will continue to worsen.

The Chairman deserves credit for urging entitlement restraint. A closer look at why these savings are needed is illuminating:

- In the forthcoming decade, mandatory outlays will continue to grow while discretionary spending shrinks, with the former reaching nearly 60 percent of the budget, and 12.8 percent of GNP by 2001 (compared with 11.4 percent now). These trends are clear in the Chairman's baseline, as well as in the ten-year projection furnished by the Congressional Budget Office.[5]

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[5] The projections were presented in an October 1991 CBO Staff Memorandum titled Budget Projections Through 2001. In other references, this document will be cited as CBO Memo.

- Entitlements are consuming 47.7 percent of Federal outlays this year, and will reach 57.7 percent by 2001. By contrast, discretionary accounts will shrink from 40.3 percent of the budget in 1991 to 31.3 percent by 2001.

- Entitlements will account for at least two thirds of cumulative spending growth throughout the period. It is important to note that this growth projection assumes only existing mandatory programs, *without the adoption of any expanded benefits or new entitlements.*

- Mandatory spending, for existing programs only, will total $10 *trillion* in the next decade. That is roughly the size of the entire projected GNP in 2001.

- The demands on Medicare and Social Security -- the largest entitlement programs, neither of which is means-tested -- will grow even more dramatically *after* 2001, when the baby boomers retire and become eligible for Medicare benefits.

The entitlement problem is especially acute in the health care programs -- Medicare and Medicaid -- which are growing much faster than other entitlements partly because medical care inflation is substantially higher than the growth in the non-medical Consumer Price Index (CPI). Because the Federal Government is a major purchaser of health care, its spending habits contribute to upward-spiraling medical costs. By the same token, the Government can help contain these costs by controlling its own expenditures. It could do so by refusing to raise medical care entitlement outlays by more than the increases resulting from identified benefit expansions, demographic changes, and *non-medical* inflation.

Because the need to tackle entitlements is great, the objectives recommended by the Budget Committee will have to be ambitious. In all likelihood, the targeted savings will need to exceed the $400 billion suggested by the Chairman. It is unnecessary to demand that mandatory spending provide deficit reduction in the exact proportion that it consumes resources. But because entitlements are the largest part of the budget -- and are the part most difficult to control -- it makes sense to suggest that they represent the most likely source of potential budget savings.[6]

The Budget Committee also should outline specific kinds of entitlement reforms that could be undertaken. We cannot afford to count on a "broad national health care plan" that does not yet exist, regardless of how beneficial such a plan might be. Budget Committee members should face squarely the specific decisions that could be made with regard to existing entitlement programs. These options, which were presented to committee members, include the following:

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[6] As noted above, defense and domestic discretionary accounts combined will represent 34.8 percent of total Federal spending in Fiscal Year 1993, and all discretionary accounts add up to 31.3 percent of Federal spending by 2001, in the Chairman's baseline. Yet they represent as much as 51.9 percent of the Chairman's deficit reduction plan. Meanwhile, entitlements are consuming 47.7 percent of Federal outlays in 1991, and that share balloons to 57.7 percent by 2001; yet these accounts would furnish as little as 13 percent of the Chairman's proposed deficit reduction, and a maximum of 40 percent.

- o Relate SMI premiums to Medicare beneficiaries' incomes. Cumulative savings 1993-2001: $150 billion.

- o Increase the Medicare Part B deductible to $150 in 1993 and index to inflation. Cumulative savings 1993-2001: $35.3 billion.

- o Increase Medicare Part B premium to cover 30 percent of the program's cost. Cumulative savings 1993-2001: $44.6 billion.

- o Increase Medicare Part B coinsurance to 25 percent. Cumulative savings 1993-2001: $43.9 billion.

Table 3. Panetta Baseline: Discretionary Versus Mandatory Spending, 1993-2001

Outlays in Billions of Current Dollars

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295	292	292	297	301	313	325	339	353
International	21	22	23	24	25	26	27	28	29
Domestic	225	239	250	261	271	281	291	303	314
Subtotal	541	553	565	582	597	620	643	670	696
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Total Spending	1502	1549	1558	1628	1731	1842	1962	2092	2227

Outlays as a Percent of Total Spending

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	19.6	18.9	18.7	18.2	17.4	17.0	16.6	16.2	15.9
International	1.4	1.4	1.5	1.5	1.4	1.4	1.4	1.3	1.3
Domestic	15.0	15.4	16.0	16.0	15.7	15.3	14.8	14.5	14.1
Subtotal	36.0	35.7	36.3	35.7	34.5	33.7	32.8	32.0	31.3
Mandatory Spending	49.3	50.8	53.9	55.0	55.6	56.0	56.6	57.2	57.7

Outlays as a Percent of GNP*

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	4.7	4.4	4.1	3.9	3.8	3.7	3.6	3.6	3.5
International	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Domestic	3.6	3.6	3.5	3.5	3.4	3.3	3.2	3.2	3.1
Subtotal	8.6	8.3	8.0	7.7	7.5	7.3	7.2	7.0	6.9
Mandatory Spending	11.7	11.7	11.8	11.9	12.0	12.2	12.4	12.6	12.8
Total Spending	23.8	23.1	21.9	21.6	21.7	21.7	21.9	22.0	22.1

*GNP estimates are from the CBO Staff Memorandum Budget Projections Through 2001, October 1991.

Source: The Chairman's Report.

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- o Eliminate the VA compensation for veterans with 10-percent disability ratings. Cumulative savings 1993-2001: $9 billion.

- o Increase the VA housing loan origination fees by 0.5 percent and extend the 0.625-percent increase scheduled to sunset. Cumulative savings 1993-2001: $1.85 billion.

Table 4. Breakdown of Projected Mandatory Spending 1993-2001

Outlays in Billions of Current Dollars

Social Security	301	319	337	357	377	399	422	446	472
Medicaid	71	81	92	105	118	133	150	168	189
Medicare	141	156	174	194	217	240	267	298	328
Civil Service Retirement	36	38	40	44	47	49	52	55	59
Military Retirement	26	27	29	30	32	34	36	38	40
Other	166	165	166	165	171	178	184	191	198
Total	740	787	839	895	962	1032	1111	1196	1286

Outlays as a Percent of Total Federal Spending

Social Security	20.1	20.8	22.0	22.2	22.0	21.9	21.7	21.5	21.4
Medicaid	4.7	5.3	6.0	6.5	6.9	7.3	7.7	8.1	8.6
Medicare	9.4	10.2	11.3	12.1	12.7	13.2	13.7	14.4	14.9
Civil Service Retirement	2.4	2.5	2.6	2.7	2.7	2.7	2.7	2.7	2.7
Military Retirement	1.7	1.8	1.9	1.9	1.9	1.9	1.9	1.8	1.8
Other	11.1	10.8	10.8	10.3	10.0	9.8	9.5	9.2	9.0
Total	49.3	51.3	54.7	55.8	56.1	56.5	57.1	57.7	58.3

Outlays as a Percent of Gross National Product*

Social Security	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Medicaid	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9
Medicare	2.2	2.3	2.4	2.6	2.7	2.8	3.0	3.1	3.3
Civil Service Retirement	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Military Retirement	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other	2.6	2.5	2.3	2.2	2.1	2.1	2.1	2.0	2.0
Total	11.7	11.7	11.8	11.9	12.0	12.2	12.4	12.6	12.8

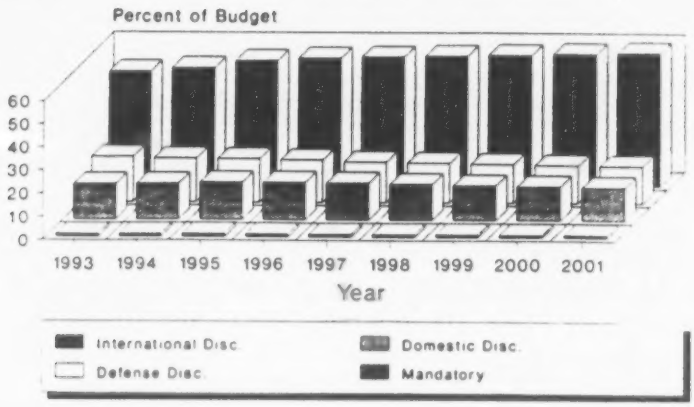
*Based on Congressional Budget Office Projection of GNP.

Source: Congressional Budget Office

This listing is not presented as a categorical endorsement of these policies. All of them would require serious debate about the policies underlying these programs. But several points must be made about the items above. First, they represent more than $284 billion in potential entitlement savings not discussed in the Chairman's report. Second, they are steps that could be taken right now, even without a broad reform of the health care system. Third, and perhaps most important, actions such as these hold a real potential for containing the

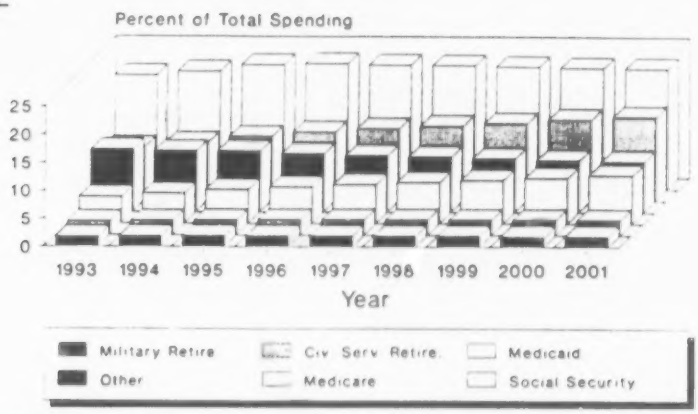
rapid growth of entitlement spending.[7] Given the magnitude and intractability of the entitlement problem, the Budget Committee should note these possibilities and make recommendations to the appropriate authorizing committees. These matters must be considered in any serious debate about entitlement spending. That debate must occur, and soon, or entitlements will continue to absorb more and more Federal resources.

Figure 1. Projected Federal Spending, 1993-2001: Defense, International, Domestic Discretionary and Mandatory as Percents of the Total Budget



Source: The Panetta Baseline.

Figure 2. Breakdown of Projected Mandatory Spending 1993-2001 as Percents of Total Federal Spending



Source: Congressional Budget Office.

[7] The Chairman's report acknowledges that even comprehensive health care reforms with cost-control mechanisms and fewer payors might not reduce the underlying growth rate in medical costs.

DEFENSE

To understand why some Committee members are reluctant to endorse steeper or faster reductions in national defense, as the Chairman proposes, it is useful to examine the current downsizing of U.S. forces in budgetary terms.[8]

As mentioned earlier, the Chairman's baseline applies a different standard for defense outlays from that of domestic and international discretionary spending. The baseline for the latter two categories would allow them to grow with inflation, disregarding the BEA spending caps for 1994 and 1995. With defense, however, the Chairman assumes the shrinking outlays that already have been accepted by the Administration.

The amount of defense reduction in the Chairman's baseline alone is substantial. As shown in Table 5, compared with the CBO baseline independent of the discretionary caps -- the same assumption used by the Chairman in developing his baseline for international and domestic discretionary spending -- defense spending in the Chairman's baseline is reduced by a total of $345 billion from 1993 through 2001. Defense outlays in the Panetta baseline decline to 3.5 percent of GNP, compared with 4.0 percent in the CBO figures. Whether such reductions are appropriate is a question unto itself. The point here is that substantial long-range reductions are built into the Panetta baseline for defense, but not for other discretionary categories. *It is from this declining defense figure that the Chairman would trim an additional $174 billion to $419 billion.*

As noted earlier, U.S. defense spending has been declining since 1985. By 1996, the cumulative real decline (after accounting for inflation) in defense budget authority since 1985 will have reached 34 percent. Virtually all of this "peace dividend" will have been absorbed in higher domestic spending.[9] Defense budget authority declined from 7.4 percent of GNP in 1985 to 5.1 percent of GNP in 1991. Meanwhile, total Federal BA stayed level at just over 27 percent of GNP -- because in effect the defense savings were spent on non-defense programs, principally entitlements. This trend continued with the 1990 budget agreement, as noted by CBO Director Reischauer:

> The caps for Fiscal Year 1991 required that discretionary defense budget authority be reduced by 8 percent in real terms below the 1990 appropriations level, and that international budget authority be reduced by 5 percent. Domestic discretionary budget authority in 1991 was permitted to increase by 7 percent above the inflation-adjusted 1990 level (or by 3 percent, if the renewal of expiring subsidized housing contracts is excluded from the comparison). . .

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8 Using the Chairman's baseline, defense will account for 17.4 percent of Federal spending from 1993 through 2001, and 8 percent of Federal spending growth. The Chairman's deficit reduction plan plan envisions defense savings that could reach as high as 41 percent of the total deficit reduction sought.

9 December 8, 1989 memorandum to House Budget Committee Republicans by Scott Salmon, then defense analyst for the Committee's Republican staff.

In 1992 and 1993, the discretionary spending limits in the Budget Enforcement Act require substantial further reductions only in the defense category. The limits on budget authority for international and domestic discretionary spending in those years exceed the 1991 appropriations, after adjusting them for inflation, by small amounts.[10]

This is not to say that defense spending should not be re-examined. But any such examination should take place in the context of demonstrable changes in national security needs. In the words of Armed Services Committee Chairman Les Aspin, the current 25-percent build-down plan for the U.S. military "has proved durable because it was based on concrete, enduring changes in the military threat to the United States."[11] That should be the standard for the future.

Table 5. Panetta Defense Baseline versus CBO Defense Baseline without BEA Discretionary Caps

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
CBO[a]									
$(Billions)	306	316	323	333	344	359	374	390	407
% of GNP	4.9	4.7	4.5	4.4	4.3	4.2	4.2	4.1	4.0
Panetta									
$(Billions)	295	292	292	297	301	313	325	339	353
% of GNP	4.7	4.4	4.1	3.9	3.8	3.7	3.6	3.6	3.5
Difference (Panetta vs. CBO Baseline)	-11	-24	-31	-36	-43	-46	-49	-51	-54

Total Reductions in Panetta Baseline from CBO Baseline = $345 Billion

[a]The CBO baseline used here assumes defense spending growth at inflationary levels. It is the same premise used to calculate the Panetta baselines for domestic and international discretionary spending.

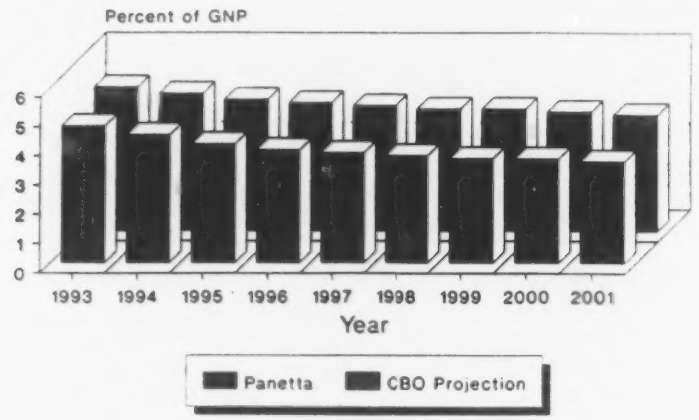
Source: The Panetta Baseline and the Congressional Budget Office.

Furthermore, members should be cautious about justifying steeper defense cuts by virtue of continuing changes in the Soviet Union. Many hoped-for changes in the U.S.S.R -- completion of Soviet withdrawals from Poland and Eastern Germany; compliance with arms control agreements and announced unilateral actions; further reductions in strategic forces; further reductions in conventional forces; continued movement toward openness, democracy, and private enterprise -- are under way, and already are assumed in the Pentagon's plans and the Budget Enforcement Act. To the extent that further progress occurs, further adjustments in the U.S. defense budget can be made then.

10 See Reischauer's July 16, 1991 testimony to the Senate Budget Committee.

11 Aspin speech to the Air Force Association Annual National Convention, September 17, 1991.

Figure 3. Panetta Defense Baseline v. CBO Defense Baseline without BEA Discretionary Caps as Percentages of GNP



Source: The Panetta Baseline and Congressional Budget Office.

A re-examined defense plan needs to be forward-looking, and the threats facing the U.S. in the future very likely will be different from those of the past. Again, these threats, for the most part, already are included in the Pentagon's current plans and the BEA. They include the proliferation of sophisticated weapons and ballistic missiles, the spread of nuclear and chemical weapons, and international terrorism.

A final, additional cautionary note should be added. The force engaged in the Persian Gulf War often is used as a standard for measuring future military needs. *But that does not mean that trimming the total U.S. military to somewhere near that level would leave a force adequate for the same task in the future.* A smaller force would mean that military planners would have less flexibility to rotate troops. Therefore, they would be far less able to "wait out" an adversary. After a very short time, their options would be limited to engaging in combat or pulling out. In addition, if the vast majority of U.S. forces were committed to one engagement, American interests could be threatened elsewhere.

To summarize, defense spending should be re-examined on the basis of demonstrable changes in the threat to the U.S. *vis a vis* the current BEA defense baseline. Such changes cannot reliably be predicted beyond the next year or two; defense budgets will simply have to respond to that reality.

NON-DEFENSE DISCRETIONARY SPENDING AND INVESTMENTS

Domestic discretionary spending has been controlled, as the Chairman's report correctly says. Programs in this category have not caused soaring deficits; sharp cuts below this year's $212 billion level are not necessary or prudent. That is the end of the good news.

The Chairman's report prescribes cumulative net savings of between $70 billion and $100 billion in both international and domestic discretionary spending. These savings are measured from a $2.6 trillion cumulative trend line that fully allows for inflation beginning in FY 1994. But if deficit-reduction is seriously pursued, greater savings in these categories may well be necessary. These savings might be achieved by restraining spending growth to levels below inflation, or by increasing the amount of planned budget reductions.

More important, the continuing projected deficits make it highly unlikely that $300 billion to $370 billion of new investments can be added to total domestic spending, as the Chairman proposes. Instead, if new investments are undertaken, they will have to *displace* lower priority programs. In other words, Congress will need to target more of its *available* resources to the programs of greatest importance, and less to those that are less important -- rather than simply adding new programs (and hoping for more resources).

This will not be an easy task. Political agreement is much more readily achieved on new investment programs than on ways to pay for them. Recent experience suggests that neither trimming back sharply on programs nor increasing revenues seems realistic, even when a popular initiative is at stake. Support for the Chairman's report, therefore, should not be predicated on an expectation that the outlined investments can be enacted.

In addition to the budgetary concerns, it should be noted that the investments proposed in the Chairman's report represent *this* year's wishes and priorities. An entirely different election-year agenda or set of investment needs may have arisen in two, four, or eight years. This is one of the hazards of outlining such new investments as part of a long-range budget plan.

Streamlining government, identified as a major component of the Chairman's domestic discretionary savings, is a commendable goal. So is performance-based budgeting, which should be required as part of the streamlining process. Every cabinet agency should test ways to make sure that discretionary programs are accomplishing their purposes and that Federal taxpayers are getting the full value from their investment. Both initiatives deserve serious consideration, and are well worth undertaking on their own merits. But it would be imprudent to assume large budget savings from these pursuits. History has shown that such efforts simply do not produce substantial budget reductions. In addition, the continuing proliferation of new cabinet agencies indicates the practical and political difficulty of streamlining the Government, and the scant promise that it will achieve significant budgetary savings.

REVENUES

As noted earlier, the Chairman's decision to seek deficit reductions through spending restraint rather than tax increases should be applauded. But considering the many uncertainties on which his package is based, higher taxes still could be an almost certain result. There are many good reasons why such an outcome should be rejected.

Federal taxes are indeed high by historic measures. The Federal tax claim on Gross National Product will remain at or above 19 percent through the end of the decade, under current law. Never before have Federal taxes stayed so high for so long. Whether this level of taxation is to blame for the sluggish economy could be debated at length. What is certain is that reducing the deficit would improve economic conditions, but current tax levels aren't moving the budget in that direction either. This is because tax increases in the 1990 budget agreement began immediately, while significant domestic spending restraint is put off until the out-years. Thus, taxes are rising but the deficit isn't shrinking much.

The CBO baseline foresees Federal spending at 21.9 percent to 22.9 percent of GNP in 2001 (depending on whether the current BEA caps hold). Taxes through the decade peak at 19.4 percent of GNP from 1993 through 1995 (according to CBO's baseline), and then gradually decline to 18.9 percent.[12]

If Congress moves toward higher tax levels -- near the 20 percent of GNP mark -- it should be aware of how unusual this would be.

Since 1940, Federal receipts have reached or exceeded 20 percent of GNP only four times, and three of those were during wars. The first two -- 1944 (21.7 percent) and 1945 (21.3 percent) -- helped finance outlays above 40 percent of GNP, and were accompanied by deficits greater than 20 percent of GNP. The third, in 1969 (20.1 percent), was during the Vietnam War, and also was the last time the Federal Government had a surplus: outlays were 19.8 percent of GNP. The fourth instance was 1981 (20.1 percent).

The average of receipts as a percent of GNP since 1970 is 18.7 percent.

Put simply, a sustained tax level of 20 percent of Gross National Product or higher would be unprecedented. But even more in doubt is where these revenues would come from. According to CBO, individual income taxes -- the largest share of Federal receipts -- will rise from 8.4 percent of GNP in 1991 to 9.1 percent in 2001, assuming the continuation of current tax law.[13] Increasing the amount of Federal receipts from this source might contradict the current desire among some to cut middle-class taxes. Social insurance taxes, the second largest source of Federal income, will reach 7.2 percent of GNP in 1993 and

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12 CBO Memo.

13 Ibid.

remain flat for the rest of the decade. But an increase in these taxes would add to the uneven distribution of tax burden among classes that some have alleged. The third major category is corporate income taxes, which actually will decline from 1.8 percent to 1.3 percent of GNP.[14] But this decline will result from a fall-off in corporate profits; it is not the result of declining corporate tax rates.

There is good reason to doubt that Congress and the voters would endorse a tax increase. In August this year, the Public Works Committee produced a transportation authorization bill calling for a 5-cent increase in the gasoline tax. Politically, this was one of the most feasible tax increases that could be adopted. Furthermore, it was attached to a bill fashioned to be attractive to a majority of Members. But the reaction to this proposed tax increase was so strong that the Leadership decided not to bring it to the floor.

CBO's revenue projections show receipts reaching 19.4 percent of GNP in 1993, remaining at that level through 1995, and then gradually declining. The Committee should recommend that no tax increases should be considered until 1995 at the earliest, if at all. That would force Congress to maximize spending reductions, and would allow the economy to fully absorb the tax levels up to that point -- rather than adding another boost to taxes that already are rising.

Recommendations in Response to the Chairman's Budget Plan

As stated earlier, looking at long-range projections offers valuable perspectives for budget planners. But there is no substitute at present for year-by-year budgeting. That fact will be abundantly clear, once again, within the next two months. The recommendations below stem from that recognition.

1. Maintain and refine the 1990 agreement

The separate spending caps for defense, international, and domestic discretionary spending should be extended through 1995, and the "firewalls" separating these categories from one another, and from entitlements and revenues, also should be extended. This arrangement has worked so far; the deficit, though high, would be much worse otherwise.[15] Maintaining separate spending categories would offer a degree of predictability in these categories that will be lost if the caps are combined, as currently planned.

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[14] Ibid.

[15] Mid-Session Review, Office of Management and Budget, July 15, 1991, and the Chairman's own commentary.

2. Entitlements

The focus of budget control and deficit reduction must be entitlements. The Pay-As-You-Go system of the Budget Enforcement Act should be continued, *coupled with caps on total entitlement outlays*, as the Chairman advocates. The spending limits should be achieved through reconciliation, if necessary.

3. Alternative Baseline

Although the baseline should be used only for analysis, it should be internally consistent and should retain the spending caps enacted under the Budget Enforcement Act of 1990.

As noted earlier, the Chairman's baseline assumes inflationary growth for domestic and international discretionary spending starting in 1993. Its figures are consistent with the CBO projections in these categories *without the caps*. Only defense in the Chairman's baseline is trimmed below inflationary increases, to a degree roughly consistent with where the Adminstration and CBO expect defense to be. But even with these defense reductions, the Panetta baseline exceeds the BEA's aggregate discretionary caps in 1994 and 1995.

A preferable baseline would be developed as follows (see Table 6):

- It would accept the Panetta defense and international numbers, acknowledging that the defense figure already assumes substantial reductions in military spending and a consequent downsizing of U.S. national security forces.

- It would employ the CBO projection for total discretionary spending *assuming that the BEA caps hold* in FY 1994 and FY 1995.

- It then would interpolate what domestic discretionary spending would be, by subtracting the defense and international amounts from the aggregate discretionary total allowed by the BEA caps in 1994 and 1995. The domestic discretionary figure would be a ceiling, not a floor.

A baseline developed in this way would have several advantages over the baseline presented in the Chairman's report.

- It would assume unequivocally that Congress anticipates adhering to the BEA caps. The caps are acknowledged as having contributed significantly to budget control.

- It would build into the baseline $112 billion more in savings (not counting deposit insurance, net interest, or offsetting receipts) compared with the Chairman's baseline. Because this would bring the deficit below the Chairman's baseline assumption, interest costs also could decline, providing additional savings.

Table 6. Panetta Baseline v. Alternative Baseline.

Panetta Baseline (Outlays)

(in Billions of Current Dollars)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295	292	292	297	301	313	325	339	353
International	21	22	23	24	25	26	27	28	29
Domestic	225	239	250	261	271	281	291	303	314
Subtotal	541	553	565	582	597	620	643	670	696
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Total Spending*	1281	1340	1404	1477	1559	1652	1754	1866	1982

Proposed Alternative Baseline (Outlays)

(in Billions of Current Dollars)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Discretionary Spending									
Defense	295	292	292	297	301	313	325	339	353
International	21	22	23	24	25	26	27	28	29
Domestic	225	225	229	242	259	269	281	291	302
Subtotal	541	539	544	563	585	608	633	658	684
Mandatory Spending	740	787	839	895	962	1032	1111	1196	1286
Total Spending*	1281	1326	1383	1458	1547	1640	1744	1854	1970
Savings (Alternative v. Panetta	0	14	21	19	12	12	10	12	12

Total Savings = $112 billion

*Not counting deposit insurance, net interest, or offsetting receipts.

Sources: The Panetta Baseline, the Congressional Budget Office, and the House Budget Committee Republican Staff.

- It would assume the additional savings would go toward deficit reduction, because it would be built into the baseline.

- It would direct any "peace dividend" toward deficit reduction, rather than spending part on domestic discretionary programs. In the Chairman's baseline, part of the defense savings (compared with CBO's inflation-adjusted defense baseline shown in Table 5) are used to protect domestic discretionary spending from inflation.

4. Maintain the Focus on Deficit Reduction

Achieving a balanced budget -- or one with a surplus -- should be the primary long-range goal of long-range budget planning. This would have the result of both stabilizing Federal budgeting and contributing to national savings.[16]

[16] See "Is a Balanced Budget Enough?" in the AEI Economist, July 1987.

5. **Revenues**

No additional taxes should be considered through 1995, if at all. The tax component of the budget agreement already is in place and should not be added to.Federal receipts will rise from 18.9 percent of GNP in 1991 to 19.4 percent in 1993 and remain at that level through 1995. The economy should be allowed to absorb this level of taxation without being hit with another increase, especially considering that growth already is expected to be sluggish. The economy will benefit from a stable tax climate. More tax revenue will only tempt Congress away from the real spending restraint that is necessary.

Such a commitment would require a change in the PAYGO rules along the lines of the Brown Amendment to the FY 1992 Senate Budget Resolution. Specifically, any entitlement expansions would have to be offset with other spending reductions, not with higher taxes. But considering the urgent need to restrain entitlement spending, the point should be moot.

These recommendations might not seem as exciting as investment spending plans that reach to the next millenium. They would not be easy to implement. But they are based on a realistic strategy that has proved its value. They constitute an approach that *can* achieve real reductions in the Federal budget deficit -- the most important goal cited in the Chairman's report and this one.